India's FDI Inflows

Trends & Concepts

RIS
Research and Information System
for Developing Countries

Institute for Studies
in Industrial Development
ISID

About RIS

The Research and Information System for Developing Countries (RIS), a New Delhi based autonomous think-tank under the Ministry of External Affairs, Government of India, is an organization that specializes in policy research on international economic issues and development cooperation. RIS is envisioned as a forum for fostering effective policy dialogue and capacity-building among developing countries on international economic issues.

The focus of the work programme of RIS is to promote South-South Cooperation and assist developing countries in multilateral negotiations in various forums. RIS is engaged in the Track II process of several regional initiatives. RIS is providing analytical support to the Government of India in the negotiations for concluding comprehensive economic cooperation agreements with partner countries. Through its intensive network of policy think tanks, RIS seeks to strengthen policy coherence on international economic issues.

About ISID

The Institute for Studies in Industrial Development (ISID), successor to the Corporate Studies Group (CSG), is a national-level policy research organization in the public domain and is affiliated to the Indian Council of Social Science Research (ICSSR). Developing on the initial strength of studying India's industrial regulations, ISID has gained varied expertise in the analysis of the issues thrown up by the changed policy environment. The Institute's research and academic activities are organized under the broad thematic areas of industrial development, corporate sector, trade, investment and technology, employment, labour and social sector and media studies.

As adjunct to its research activities, ISID has developed databases on various aspects of the Indian economy, particularly concerning the industrial and corporate sectors. It has created On-line Indexes of 175 Indian Social Science Journals (OLI) and 15 daily English Newspapers. More than one million scanned images of Press Clippings on diverse social science subjects are available online to scholars and researchers. These databases have been widely acclaimed as valuable sources of information for researchers studying India's socio-economic development.

India's FDI Inflows
Trends and Concepts

K.S. Chalapati Rao

Biswajit Dhar

RIS
Research and Information System for Developing Countries

Institute for Studies in Industrial Development **ISID**

Published in 2011 by:

RIS
Research and Information System for Developing Countries

Core IV-B, Fourth Floor,
India Habitat Centre, Lodhi Road,
New Delhi-110 003 India.
Ph.: 91-11-24682177-80
Fax: 91-11-24682173-74
Email: publication@ris.org.in
Website: http://www.ris.org.in

Institute for Studies in Industrial Development **ISID**

4, Institutional Area Phase-II, Vasant Kunj,
New Delhi - 110 070, India.
Ph.: 91-11-2676 1600-1899
Fax: 91-11-26761631
Email: info@isid.org.in
Website: http://www.isid.org.in

Preface

The kernel of this study was developed many springs back when the authors were in their early years as researchers at the Corporate Studies Group (CSG) of the Indian Institute of Public Administration, New Delhi. With far reaching changes taking place in India's foreign investment policies, it was felt necessary to come together once again and delve deep into the analytical underpinnings of the policy. The stated objective of the modified foreign investment policies, particularly those that relate to foreign direct investment (FDI), is to ensure that India benefits from the multifarious advantages that this form of capital brings to the host countries. Broadly speaking, policy makers in India have increasingly viewed FDI as an essential component of the country's development endeavours. This expectation is, however, dependent on the nature of the FDI that is flowing in. In other words, it is necessary to examine whether the entities that are the embodiment of FDI in India are such that can transfer the benefits that the policy makers are expecting from them. This monograph is a modest attempt to understand the key features of FDI that has entered India in the recent past.

At the CSG the authors imbibed the approach that public policy analysis relating to corporate and industrial sectors is better done at the unit level and that one should take into account both qualitative and quantitative aspects as well as official pronouncements. Experience at the CSG also taught them to painstakingly piece together scattered information on large number of entities. The authors are conscious of the fact that the present study is but a small step towards understanding of the FDI in India with possible ramifications for similarly placed countries. Further elaboration of some of the issues taken up here as also other related aspects is on the anvil. We do welcome suggestions and comments to make the analysis more useful.

Over the long journey spanning more than two and a half decades, the authors have benefitted from interacting with several mentors and colleagues, individually or together. They include Professors S.K. Goyal, Gerd Junne, Jan ter Wengel, Nasir Tyabji, M.R. Murthy, K.V.K Ranganathan and Surajit Mazumdar. We owe a lot to them.

Both ISID and RIS actively supported the study and allowed us to pursue it unhindered. This has enabled us to organize data and information and develop the arguments in an incremental manner. The collaborative work got a further fillip when a joint Symposium was held in March 2010. While support was extended by many individual staff members of the two institutes, we would like to make a special mention of the involvement of Sudhir Aggarwal and Dhanunjai Kumar of ISID and Tish Kumar Malhotra and Sachin Singhal of RIS.

New Delhi
29 September 2011

K.S. Chalapati Rao
Biswajit Dhar

CONTENTS

India's FDI Inflows

Trends and Concepts

K.S. Chalapati Rao* and Biswajit Dhar**

Abstract: India's inward investment regime went through a series of changes since economic reforms were ushered in two decades back. The expectation of the policy makers was that an "investor friendly" regime will help India establish itself as a preferred destination of foreign investors. These expectations remained largely unfulfilled despite the consistent attempts to increase the attractiveness of India by further changes in policies that included opening up of individual sectors, lowering the hitherto existing caps on foreign holding and improving investment procedures. But after 2005–06, official statistics started reporting steep increases in FDI inflows. This paper is an attempt to explain this divergence from the earlier trend.

At the outset, this study dwells on the ambiguities surrounding the definition of FDI and the non–adherence to international norms in measuring the FDI inflows by India. The study finds that portfolio investors and round–tripping investments have been important contributors to India's reported FDI inflows thus blurring the distinction between direct and portfolio investors on the one hand and foreign and domestic investors on the other. These investors were also the ones who have exploited the tax haven route the most. These observations acquire added significance in the context of the substantial fall in the inflows seen during 2010–11.

In most countries, particularly those that have faced chronic current account deficits, obtaining 'stable' long term FDI flows was preferred over 'volatile' portfolio investments. This distinction between long-term FDI and volatile portfolio investments has been now removed in the accepted official definition of FDI. From an analytical point of view, the blurring of the lines between long-term FDI and the volatile portfolio investments has meant that the essential characteristics of FDI, especially the positive spill-overs that the long-term FDI was seen to result in, are being overlooked. FDI that is dominated by financial investments, though a little more stable than the portfolio investments through the stock market, cannot deliver the perceived advantages of FDI. The consequence is a double whammy: while much of the capital inflows recorded as FDI cannot enhance India's ability to earn foreign exchange through exports of goods and services, large inflows of portfolio capital cause currency appreciation and thus erode the competitiveness of domestic players.

* Mr. K.S. Chalapati Rao, Professor, ISID. Email: rao@isid.org.in

** Dr. Biswajit Dhar, Director-General, RIS. Email: biswajit@ris.org.in

Even at the global level, the developmental impact of FDI is being given lesser importance notwithstanding the repeated assertions by some to the contrary. Acceptance of the definition of FDI based on only 10 per cent voting rights, and which ignores the essential attributes of the foreign investor, could have contributed to this discourse in no small measure. There is a need to take a close look at the present phenomenon of FDI. A move away from this situation seems possible only if FDI is defined precisely instead of the omnibus capital flow which it has been turned into now. UNCTAD with its mandate to promote "the development–friendly integration of developing countries into the world economy" appears to be not only the appropriate institution that should take the lead to clear the haze but also the one having the responsibility to do it. On her part, India should build an information base that will allow a proper independent assessment of the contribution that FDI can make to her economic development.

1. Introduction

Over the past half a century, perceptions of the role played by foreign direct investment (FDI) in the development process has undergone several changes. In the 1960s, FDI was seen in most countries as a partner in the development endeavours.[1] However, the mood turned sharply in the opposite direction from the close of the decade when transnational corporations (TNCs), the chief vehicles for FDI, were viewed as agents that were undermining the sovereignty of the nation states.[2] The dominant approach therefore was to "monitor, restrict and regulate the activities of TNCs".[3] Following the commercial bank debt crisis and the aid fatigue, in the 1980s, FDI became the preferred source once again, as countries became more attracted towards non-debt creating sources of external private finance.[4] Since then, more attention is being paid to the possible role of FDI in economic development. An extensive amount of literature on FDI has emerged regarding its role in not just augmenting domestic savings for investment but more as provider of technologies and managerial skills essential for a developing country to achieve rapid economic development. While many questions relating to the impact of TNCs on development have remained controversial, the focus now is more on how to maximize the positive effects of FDI.[5]

India adopted a regime that was perceived to be restrictive towards FDI. Explicit curbs on foreign investment were imposed through the introduction of the Foreign Exchange Regulation Act (FERA) in 1973 by restricting foreign ownership of shares in enterprises incorporated in India. At the same time, foreign firms operating in India were subjected to "local content" and "foreign exchange balancing" rules that curbed their freedom of operation. The Industrial Licensing System under the Industries Development and Regulation Act, 1951 and the Monopolies and Restrictive Trade Practices Act, 1969 sought to channelise their activities into high technology and export-oriented production.[6]

The limits on foreign shares fostered joint ventures with Indian entrepreneurs. These policies continued until the policy of creeping liberalisation of the Indian economy was initiated in the 1980s. The fast-tracked liberalisation of the Indian economy introduced in 1991 brought with it a radical shift in the policy towards FDI. In fact, FDI policy reform formed part of the first package of industrial reforms in July 1991[7] and was reflected in the Industrial Policy announced in 1991:

> Foreign investment would bring attendant advantages of technology transfer, marketing expertise, introduction of modern managerial techniques and new possibilities for promotion of exports. … The government will therefore welcome foreign investment which is in the interest of the country's *industrial development*.[8] (Emphasis added)

More recently, the *Economic Survey 2008-09* reiterated that:

> FDI is considered to be the most attractive type of capital flow for emerging economies as it is expected to bring *latest technology and enhance production capabilities* of the economy.[9] (Emphasis added)

And the National Manufacturing Competitiveness Council (NMCC) opined that:

> Foreign investments mean both foreign portfolio investments and foreign direct investments (FDI). FDI brings better technology and management, access to marketing networks and offers competition, the latter helping Indian companies improve, quite apart from being good for consumers. This efficiency contribution of FDI is much more important.[10]

The change in the sentiments towards FDI were given effect to in the form of a series of changes in the policies. These included removing the ceilings on foreign equity imposed by the FERA, lifting of restrictions on the use of foreign brand names in the domestic market, removing restrictions on entry and expansion of foreign direct investment into consumer goods, abandoning the "local content" and "foreign exchange balancing" rules, among others. The parallel process of virtual withdrawal of the Industrial Licensing System and the retreating from the primacy given to public sector also enhanced the scope for FDI participation in India.

Alongside liberalizing the FDI regime, steps were taken to allow foreign portfolio investments into the Indian stock market through the mechanism of foreign institutional investors. The objective was not only to facilitate non-debt creating foreign capital inflows but also to develop the stock market in

India, lower the cost of capital for Indian enterprises and indirectly improve corporate governance structures. On their part, large Indian companies have been allowed to raise capital directly from international capital markets through commercial borrowings and depository receipts having underlying Indian equity. Thus, the country adopted a two-pronged strategy: one to attract FDI and two to encourage portfolio capital flows which ease the financing constraints of Indian enterprises. As a result of the aforementioned policy changes, India now follows an FDI-friendly regime that is quite comparable to that adopted by most countries.[11] Much of the foreign investment can now take advantage of the automatic approval route without seeking prior permission of the Central Government. Caps on FDI shareholding are now applied to only a few sectors, mainly in the services sector.[12] Concomitant steps have also been taken to remove the hurdles in the path of foreign investors both at the stage of entry and later in the process of establishing the venture. The policy changes were thus aimed at improving India's record in attracting FDI inflows, which was seen to be below its potential, particularly when compared with the massive inflows reported by China. The progressive liberalization of the foreign investment policy as well as the steps to improve the investment climate could thus be seen as attempts to overcome this perceived failure to match initial expectations and also in comparison with China.

Perceptions of foreign investors towards India changed quite distinctly as a result of the change in the policy regime. Inflows of FDI have increased substantially compared to the earlier regime in which the scope for FDI was quite restricted. From a less than $ 1 billion in the early 1990s, FDI inflows more than doubled to exceed $ 2 billion in 1995. In the early years of the previous decade, FDI inflows were pegged between $ 5-7 billion. But after 2005, the reported statistics show a steep increase in inflows: from $ 20 billion in 2006 to nearly $ 35 billion in 2009.[13] The resultant increase in the stock of FDI was staggering: from $1.7 billion at the end of 1990, FDI stock went up to $17.5 billion by the end of 2000 and further to a little above $164 bn by the end of 2009.[14] This increase in FDI inflows will have to be read in light of the fact that since 2000-01 an important change was introduced in the way FDI statistics are compiled which has made strict comparison of inflows overtime inapt. Though this did contribute to the observed increase in the reported FDI inflows, there is no denying the fact of the sharp increase in the inflows especially during the last few years. Several studies suggested that private equity inflows could have contributed substantially to the large increase in FDI in India.[15] However, this question has not been examined in any detail.

This was the starting point of our enquiry into the nature of FDI inflows in the recent past. A preliminary examination of the inflow details did throw

up the need to analyse the data more intently. Subsequently, a perusal of the Reserve Bank of India's Master Circular on Foreign Investment in India and the Draft Press Note (DPN) on FDI Regulatory Framework issued in December 2009 made us further aware of the issues that could be associated with compilation of FDI inflows in India. The present exercise is thus primarily an attempt to examine the inflow data by going beyond the broad aggregates with a view to bring out the lesser explored characteristics of FDI in India , in particular, the implications for the country's development.

The arguments in this study have been developed over several sections. We initiate the discussion by examining the conceptual and definitional issues involving measurement of FDI. We would critically examine the criteria adopted by the international agencies for identifying FDI as well as the criteria proposed by the DPN and its follow up, viz. Consolidated FDI Policy (CFP) which became effective from April 1, 2010.

The composition of FDI inflows is analysed in depth in the following section. The study covers the reported FDI inflows during September 2004 and December 2009. The choice of the period is related to the availability of data on actual inflows by the recipient companies incorporated in India, the disclosure of which was started in September 2004. Till then only approvals were being reported. Importantly, this covers the period which witnessed the sharpest increases in inflows. It may also be pointed out that the analysis provided in the study would be helpful in understanding the sharp fall in FDI inflows during 2010-11 when the reported total inflows have fallen almost by a 28.4 per cent compared to the inflows during the previous year. In view of the difficulties faced in getting the relevant information, we are constrained to term the exercise as a first approximation to the ground reality. Notwithstanding this limitation, we do hope that the exercise succeeds in creating awareness among policy makers and researchers not only in India but also at the international level that there is a need to take a closer look at the present phenomenon of FDI.

2. Conceptual and Definitional Issues

Before embarking on a discussion of India's FDI inflows and their various characteristics it would be relevant and essential to describe what has come to be internationally recognized as FDI. This could provide a basis for categorising India's inflows. Here we shall rely extensively on official documents and academic literature.

We begin by referring to the Benchmark Definition of OECD, the most relied upon definition of FDI. According to OECD, FDI is "a category of cross-border

investment made by a resident entity in one economy (the direct investor) with the objective of establishing a *lasting interest in an enterprise* (the direct investment enterprise) that is resident in an economy other than that of the direct investor" (emphasis added). Elaborating on the nature of FDI, OECD adds that "direct investment relationships, by their very nature, may lead to long-term and steady financing and technological transfers with the objective of maximising production and the earnings of the MNE [multinational enterprise] over time".[16]

OECD clarifies that it is this "motivation to significantly influence or control an enterprise is the underlying factor that differentiates direct investment from cross-border portfolio investments... Portfolio investors do not have as an objective any long-term relationship. Return on the assets is the main determinant for the purchase or sale of their securities".[17]

However, OECD moves the focus away from the above-mentioned criteria for identifying FDI "for the sake of consistency and cross-country comparability of the FDI statistics" and "a strict application of a numerical guideline is recommended to define direct investment". According to this guideline, "direct investment is considered evident when the direct investor owns directly or indirectly at least 10 per cent of the voting power of the direct investment enterprise". In the ultimate analysis, therefore, OECD adopts the 10 per cent threshold as "the criterion to determine whether (or not) an investor has influence over the management of an enterprise, and, therefore, whether the basis for a direct investment relationship exists or not."

The adoption of the 10 per cent criteria has meant that individual primary investors' investments in collective investment institutions[18] (CIIs) which acquire sufficient ownership of voting power get qualified as direct investment. This practise of identifying CIIs with FDI has been pursued despite the admission of OECD that the "nature and motivation of CIIs may differ from those of MNEs and [that] there is a need to observe this phenomenon more closely in the coming years."

While there is an operational distinction between FDI and foreign portfolio investments (FPI), John Dunning provides a better understanding of the conceptual differentiation between the two forms of investments:

> First, FDI involves the transfer of other resources than capital (technology, management, organizational and marketing skills, etc.) and it is the expected return on these, rather than on the capital *per se*, which prompts enterprises to become MNEs [multinational enterprises]. Thus capital is simply a conduit for transfer of other resources than the raison d'être for direct investment. Second, in the

> case of direct investment, *resources are transferred internally within the firm* rather than externally between two independent parties: *de jure* control is still retained over their usage. ... *These are the essential differences between portfolio and direct investment*.[19] (emphasis added)

Earlier, Stephen Hymer, in his seminal work, offered an explanation why portfolio investors seek control and made a distinction within FDI. He had classified direct investment into two types: Type 1 and Type 2.

> There are two main types of reasons why an investor will seek control. The first, which I shall call *direct investment,* Type 1, has to do with the prudent use of assets. The investor seeks control over the enterprise in order to ensure the safety of his investment. *This reason applies to domestic investment as well.*
>
> *The theory of Type 1 direct investment is very similar to the theory of portfolio investment.* The interest rate is the key factor in both. Direct investment of Type 1 will substitute for portfolio investment when the distrust of foreigners is high or when fear of expropriation and risks of exchange-rate changes are high, but its movements will still be in response to differences in the interest rate.
>
> There is another type of direct investment that does not depend on the interest rate and which I shall call direct investment of Type 2, or *international operations.* In this second type of direct investment, the motivation for controlling the foreign enterprise is not the prudent use of assets but something quite different. The control of the foreign enterprise is desired in order to remove competition between that foreign enterprise and enterprises in other countries. Or the control is desired in order to appropriate fully the returns on certain skills and abilities.[20]

It can be seen from the above that but for the dimension of "control", Type 1 direct investment is nothing but portfolio investment.[21] Buckley and Brooke's characterisation that FDI "... represents a packaged transfer of capital, technology, management and other skills, *which takes place internally within the multinational firms*" (emphasis added) is similar to Dunning's description of FDI and Hymer's elaboration of Type 2 direct investment.[22] In an elaborate review of the differences between FDI and FPI, Wilkins while noting that "capital is not homogeneous, "observed that FDI and FPI are very different, the motives are separate and the conduits are unlike. Accordingly, the respective impacts on host countries are not identical."[23]

This distinction between FDI and FPI is extremely relevant in the present context because of the changing composition of the global FDI flows as also the nature of foreign investors. Over the past decade, the rapid increase in FDI flows came on the back of spurt of collective investment institutions that include private equity and various financial investment funds like mutual funds and hedge funds.

UNCTAD in its *World Investment Report* 2010 noted that FDI by private equity funds and sovereign wealth funds together accounted for over one-tenth of global FDI flows in 2009: up from less than 7 per cent in 2000 but down from 22 per cent in the peak year of 2007.[24] PE funds are also major contributors to cross-border M&As which in turn are a major form of the global FDI phenomenon. (Table 1)

Table 1: Cross-border M&As by Private Equity firms, 2000–2010

Year	Number of Deals		Value	
	Number	Share in Total (%)	$ billion	Share in Total (%)
2000	1,338	13	92	7
2001	1,246	15	88	12
2002	1,244	19	85	18
2003	1,486	22	108	27
2004	1,622	22	157	28
2005	1,725	19	205	22
2006	1,688	18	267	24
2007	1,906	18	456	27
2008	1,776	18	303	24
2009	1,987	24	106	19
2010*	696	22	38	16

***Source*:** UNCTAD, *World Investment Report 2010*, Table I.4.
* For 2010, January–May only.
***Note*:** Includes M&As by hedge funds. Private equity firms and hedge funds refer to acquirers as "investors not elsewhere classified". This classification is based on the Thomson Finance database on M&As.

Thus, while FDI and FPI are fundamentally different in the nature of their involvement in the host economies, it is evident that the importance given to the 10 per cent share in equity capital resulted in passing-off portfolio investments as direct investments. This anomaly is recognised both by UNCTAD and OECD. The *World Investment Report*, while commenting on the phenomenon of collective investment institutions becoming the 'growing sources of FDI', stated that:

> As long as cross-border investments of private equity and hedge funds exceed the 10 per cent equity threshold of the acquired firm, these investments are classified and should be recorded as

> FDI, even if a majority of such investments are short term and are closer in nature to portfolio investments. Investments by these funds *may be the latest examples of portfolio investment turning into FDI*.[25] (emphasis added)

In an earlier comment, UNCTAD had noted that:

> Cross-border investments of private equity funds that lead to an ownership of 10 per cent or more are in most cases recorded as FDI *even if private equity funds do not always have the motivation for a lasting interest or a long-term relationship with the acquired enterprise.*[26] (emphasis added)

Yet another issue that is clear from the discussion on the new forms of capital that are included in the definition of FDI is the lack of understanding about the dynamics of these forms and their likely impact on the host countries. In this regard, OECD observed:

> CIIs are generally "brass plate" enterprises and are managed by professional investors who may offer a variety of funds with their own market orientation and who make investment decisions on behalf of investors. Administration, management, custodial and trustee services may be provided to the CIIs by separate service providers,...[27]

Emphasising that FDI by collective investment funds raises a variety of issues that deserve further research, UNCTAD poses a number of questions that include:

> [H]ow does FDI financed by private equity funds differ from FDI by TNCs in its strategic motivations? Who controls such funds? And what are their impacts on host economies?[28]

It is clear from the above discussion that private equity (including venture capital) certainly has a shorter investment horizon unlike the traditional FDI which would not start off with a pre-conceived idea of exiting an enterprise.[29] Private equity investors have the overriding objective of large and fast capital gains and revenue in other forms and there is no question/intention of integrating the investee company into their own structures like an MNC does.[30] By their very character, these are *not long-term* investors. Also, in their operations one cannot distinguish between domestic and foreign. They do not fall under any of the motives of FDI, viz. efficiency seeking, market seeking or resource/strategic asset seeking. If their investments have to be treated as FDI, they may be categorised as pure 'return seeking' FDI.

2.1 Ten per cent Threshold and Significant Influence vs. Control

Keeping the issue of classification of private equity and other collective investments *per se* aside for the time being, there is a need to have a close look at the 10 per cent threshold that differentiates direct investment from portfolio investment. Indeed, one of the tasks assigned to the Direct Investment Technical Expert Group (DITEG), a joint IMF/OECD expert group set up to make recommendations on the methodology of direct investment statistics for the revision of the IMF Balance of Payments Manual and the OECD Benchmark Definition, was to examine whether this threshold could be raised to 20 per cent. The DITEG recommended the increase in the threshold to 20 per cent in the following manner:

> The group endorsed the proposal to move to 20 per cent of voting power or ordinary shares as the threshold for the operational definition for a direct investment relationship, even though it was recognised that changing the current threshold of 10 per cent to 20 per cent would not have a significant impact on the data. The group found that there were no strong conceptual grounds for choosing 10 or 20 per cent, and so any choice below 50 per cent would be arbitrary. However, there are strong practical arguments for supporting the change to 20 per cent threshold, viz. with regard to accounting standards. International Accounting Standards (IAS) as well as the accounting standard used by the United States utilize a 20 per cent threshold for financial statements.[31] (emphasis added)

This recommendation was, however, rejected by the OECD Workshop on International Investment Statistics which decided to:

(i) maintain the current 10 per cent threshold, thus not endorsing the recommendation of DITEG to change the threshold to 20 per cent; and
(ii) maintain the strict application of the 10 per cent threshold with a view to *achieving cross-country comparability of FDI statistics*,...[32] (emphasis added)

While it is repeatedly emphasized that investors could exercise significant influence even with less than 10 per cent share in equity and that there can be situations where even a higher share in equity need not be accompanied by control, yet a strict adherence to the 10 per cent criterion is advocated for the sake of *statistical consistency* at the international level. The OECD's position in this regard is as follows:

> Some compilers may argue that in some cases an ownership of as little as 10% of the voting power may not lead to the exercise of

> any significant influence while on the other hand, an investor may own less than 10% but have an effective voice in the management. Nevertheless, the recommended methodology does *not allow any qualification of the 10% threshold* and recommends its *strict application to ensure statistical consistency across countries*. (emphasis added).[33]

It is thus evident from the foregoing that there is no objective basis for fixing the 10 per cent threshold. Moreover, the criterion has remained unchanged in the most recent exercise on the definition mainly to ensure international comparability in the presentation of statistics on FDI. On the other hand, the argument that raising the threshold would not have much impact on the FDI data needs to be looked into closely especially when the nature of foreign investors has got diversified. In this context, the assertion of IMF Balance of Payment Manual (5th Edition) needs special mention.

> Most direct investment enterprises are either (i) branches or (ii) subsidiaries that are wholly or majority owned by non-residents or in which a clear majority of the voting stock is held by a single direct investor or group. The borderline cases are thus likely to form a rather small proportion of the universe.[34]

It is, however, more likely that the lower limit of 10 per cent for ascertaining influence coupled with inclusion of investments by collective investment institutions for consideration as FDI would have resulted in the estimated FDI flows being far larger than otherwise especially in the context of the global capital flows changing their character and collective investment funds playing a major role.

A foreign investor when investing in another enterprise in the same line of activity, whether domestic or foreign, would seek control because of the involvement of many factors. While the general preference should be a wholly-owned entity, the foreign investor may settle for a lower share in case circumstances require it to enter into joint venture.[35] In each of these situations control on the one hand and directly relevant contribution to the enterprise's operation by the foreign investor on the other, are logical to expect. Going by Hymer's direct investment of Type 2, control would be necessary so as to prevent competition. In case of joint ventures it has been indeed said:

> Even if a foreign entity cannot own a majority of a joint venture, it may be able to legally obtain operational control through other means. One may surround the joint venture with contractual obligations to the foreign venturer. For example, if the joint venture is to assemble components manufactured in the United States, the

> U.S. *investor retains significant control over the joint venture regardless of how many shares the investor owns or how many directors it can name to the board* because it controls the supply of components. Similarly, a U.S. investor can exercise control through supply contracts, marketing agreements, management contracts, *and veto power in the joint venture agreements*. (emphasis added)[36]

Another relevant aspect is that the widely adopted OECD definition is based on the assumption of significant influence. Interestingly, a distinction was made by Lipsey by referring to United Nations System of National Accounts (SNA) wherein he said:

> What constitutes a foreign direct investment entity has been defined differently for balance of payments purposes and for studies of firm behaviour.
>
> The dominant current definition of a direct investment entity, prescribed for balance-of-payments compilations by the International Monetary Fund (IMF) …, and endorsed by the OECD …, avoids the notion of control by the investor in favor of a much vaguer concept (long term interest and significant influence).
>
> The IMF definition is governing for balance-of-payments compilations, but there is a different, but related, concept and a different official definition in the United Nations System of National Accounts, ... that retains the idea of control, and reflects the micro view more. In these accounts, which measure production, consumption, and investment, rather than the details of capital flows, there is a definition of "foreign-controlled resident corporations." Foreign-controlled enterprises include subsidiaries more than 50 percent owned by a foreign parent. "Associates" of which foreign ownership of equity is 10–50 percent, "*may be included or excluded by individual countries according to their qualitative assessment of foreign control…*"[37] Thus, from the viewpoint of a host country, and for analyzing production, trade, and employment, control remains the preferred concept.[38] (emphasis added)

IMF also made this point clear when it said:

> The concept described in this Manual is broader than the SNA concept of foreign-controlled, as distinguished from domestically controlled, resident enterprises. In the SNA, that distinction ... is made in the compilation of various accounts because of the distinction's potential analytic usefulness in the examination

> of differences (characteristics such as value added, investment, employment, etc.) between enterprise subsectors. Thus, linkage of the direct investment component of the *financial account* with the foreign-controlled sector is by no means a complete one, primarily because the two serve different purposes. As presented in this *Manual*, the primary distinguishing feature of *direct investment* is the significant influence that gives the investor an effective voice in management. For the foreign-controlled sector, the primary distinguishing feature is control.[39]

Thus, for economic analysis of foreign investment one needs to focus more on control and look into the circumstances of investment rather than any specific percentage. In fact, the European Commission (EC) suggested that to ascertain a direct investment relationship when the foreign investor holds less than 10 per cent of the equity, the following criteria could be taken into account to determine whether a direct investment relationship exists:

a) representation in the Board of Directors;
b) participation in policymaking processes;
c) inter-company transactions;
d) interchange of managerial personnel;
e) provision of technical information; and
f) provision of long-term loans at lower than existing market rates.[40]

On the other hand, the EC also emphasised the need to go beyond the standard definition and taking into account the national legal provisions as also circumstances.

> Situations vary very much from country to country and depend on the legal framework for corporate governance, i.e. the legislation regulating the allocation of property rights and control of enterprises. ... Precise allocation of control between national and foreign entities requires compilers of statistics not just to apply the definition but also to make a supplementary assessment.[41]

The United States has in recent years adopted new guidelines pertaining to mergers, acquisitions, and takeovers by foreign entities which have broadened the definition of foreign control. These guidelines have been introduced towards implementation of the Foreign Investment and National Security Act (FINSA) of 2007, which reformed the process by which the US government reviews the national security impact of foreign direct investments in the country. FINSA amended section 721 of the Defense Production Act of 1950 that authorized the US President "to review mergers, acquisitions, and takeovers by or with any

foreign person which could result in foreign control of any person engaged in interstate commerce in the United States, to determine the effects of such transactions on the national security of the United States".[42]

Importantly, FINSA redefined the critical issue of "control" of "foreign persons" as the

> "...power, direct or indirect, whether or not exercised, through the ownership of a majority or a dominant minority of the total outstanding voting interest in an entity, board representation, proxy voting, a special share, contractual arrangements, formal or informal arrangements to act in concert, or other means, to determine, direct, or decide important matters affecting an entity; in particular, but without limitation, to determine, direct, take, reach, or cause decisions …, or any other similarly important matters affecting an entity".[43]

It is quite clear from the approaches adopted by the two largest economies that a simple criterion like voting power of more than 10 per cent does not always provide a credible indicator of "control" over an enterprise. A case-by-case approach is adopted by the regulators in these two domains to better appreciate the issue of "ownership" and "control". Such an approach has relevance in the Indian context as the following cases would highlight.

2.2 Need for Case-by-Case Approach to Identify Foreign Direct Investment in an Enterprise

2.2.1 Tata Motors Ltd

Tata Motors Ltd (earlier Tata Engineering & Locomotive Co Ltd), India's leading truck manufacturer, entered into collaboration with Daimler Benz in 1954 for manufacturing commercial vehicles. The collaboration ended in 1969. Since then the vehicles are being called Tata Trucks instead of Tata Mercedes-Benz Trucks. But the foreign investor did not completely withdraw its investment in the equity capital of Tata Motors. Its nominee also continued to be on the board of Tata Motors. In 1986 the company started producing light commercial vehicles. In 1991 Tata Sierra SUV and later in 1992 Tata Estate MUV were launched. Tata Motors entered into a separate 49:51 JV with Daimler-Chrysler in 1994 for manufacture of Mercedes-Benz cars in the country. This alliance ended in 2001. In 1998 Tata Safari and Indica passenger cars were launched. In 2007, Tata Motors had given a no objection to the German firm's plans to set up its independent commercial vehicles business in the country. From the beginning the German investor had more than 10 per cent equity. From the time we could get the shareholding details, that is, since 2001 and until December

2009, there had been no change in the number of shares held by Daimler. However, due to the expansion of Tata motor's equity, the share of Daimler came down from 10 per cent in December 2001 to 5.34 per cent in December 2009. (Table 2) Subsequently, Daimler sold off its entire equity. On the day when the announcement came, the stock market did not react adversely to the news indicating that the divestment would not have any adverse impact on Tata Motors' working. In fact, there was a marginal increase in the company's share price on that day. Earlier Daimler's representative on the company's board did not seek re-election in the AGM held in July 2006.

Table 2: Daimler Chrysler's Investment in Tata Motors

End of	No. of Shares	per cent Share in Total
December 2001	2,55,96,476	10.00
December 2002	2,55,96,476	8.00
December 2003	2,55,96,476	7.8
December 2004	2,55,96,476	7.0
December 2005	2,55,96,476	6.8
December 2006	2,55,96,476	6.6
December 2007	2,55,96,476	6.6
December 2008	2,55,96,476	5.7
December 2009	2,55,96,476	5.3
March 2010	sold off	0.0

***Source*:** Shareholding pattern of Tata Motors Ltd as reported to the Bombay Stock Exchange.

In the prospectus issued in 1980, the company did not mention any special relationship with Daimler. It merely stated:

> As regards Daimler–Benz AG their present holding in the company is approximately 13 per cent of the subscribed equity capital. It is in the long-term interest of the Company that Daimler-Benz AG, who are world leaders in the field of automobile manufacture, maintain their equity percentage.[44]

Given this background, the pertinent issue is whether Tata Motors can be classified as an FDI company and if so till what period. For us it looks appropriate to treat it as an FDI company only till 1969 when the technical collaboration ceased, notwithstanding the continued equity participation by Daimler of at least 10 per cent thereafter and representation on the board. There is no evidence to show that the subsequent developments at Tata Motors were in any way directly contributed by Daimler.

2.2.2 Ballarpur Industries Ltd (BILT)

Another relevant case is that of Ballarpur Industries Ltd (BILT), a well-diversified leading paper manufacturing company in India. In 1998, the

company received government's permission to give 16.7 per cent stake to Al-Murjan Trading & Industrial Co Ltd of Saudi Arabia. This was the time when the Thapar group, the promoters of the company, was undergoing restructuring and was facing funds crunch. Agreement with Al-Murjan involved induction of their nominee on BILT's board. The foreign investor exited BILT in March 2005 and withdrew its nominee. (Table 3) A senior official of the company said in this context that "(T)hey sold their equity stake in the market as they are mainly a trading company and want to exit from non-core business". It is evident that Al-Murjan was only a financial investor and it could not have brought with it any additionality into the functioning of BILT. From this perspective, one can assume that BILT was not an FDI company even when Al-Murjan had more than 10 per cent equity in it.[45]

Table 3: Foreign 'Promoter' of Ballarpur Industries Ltd

End of	Name of the Foreign Investor	No. of Shares	% Share in Total
March 2001	Al-Murjan Trading & Industrial Co Ltd #	1,00,00,000	13.98
March 2002	Foreign Company	1,18,08,882	16.51
March 2003	Al Murjan Trading & Industrial Co Ltd #	1,00,00,000	7.78
Mar 2004	Foreign Companies	1,30,48,882	8.03
December 2004	Foreign Companies	1,11,98,882	6.89
March 2005	Sold off the entire shareholding	0	0.00

Source: Shareholding pattern of the company reported by the Bombay Stock Exchange website.
Shown among the promoters.

2.2.3 VST Tillers Tractors (VST)

The company, market leader in tillers, was established in 1967 as a joint venture and technical collaboration with Mitsubishi Heavy Industries and Mitsubishi Corporation, Japan for the manufacture of Power Tillers and Diesel Engines. In 1984, an additional technical and financial collaboration was entered into with Mitsubishi Agricultural Machinery Company Ltd, Japan for the manufacture of 18.5 HP, 4-wheel drive Tractor. According to the earliest available shareholding pattern of the company (June 2002), the foreign collaborators had 3.78 per cent equity shareholding. Subsequently, this shareholding was shown against foreign promoters, Mitsubishi Heavy Industry Pvt. Ltd being one of them. The company's annual report also acknowledged the joint venture partners, Mitsubishi Heavy Industries Ltd

and Mitsubishi Machinery Co Ltd, Japan till 2003-04. It is only in 2006-07 when the company promoted MHI-VST Diesel Engines Pvt Ltd as a joint venture with the Mitsubishi group that the representation on the company's board was reduced from two to one.

It is pertinent to note that the Articles of Association of VST specifically state that:

> The regulation for the management of the Company and for the observance of the members thereof and their representatives shall be such as are contained in these Articles. The Company shall adopt and carry into effect the Joint Venture agreement dated 10th November 1966 entered into by the Promoters with the Joint Venture partners M/s. Mitsubishi Heavy Industries Ltd. and Mitsubishi Corporation (formerly known as Mitsubishi Shoji Kaisha Ltd, Japan). The aforesaid agreement shall form a part of these articles of association for all intents and purposes and particularly the provisions contained therein relating to transfer of shares and pre-emptive rights of the parties thereto, to acquire the shares.
>
> The joint venture partners M/s. Mitsubishi Heavy Industries Limited, M/s. Mitsubishi Corporation and M/s. Mitsubishi Agricultural Machinery Company Limited, Japan shall be collectively entitled to appoint one Director mentioned in clause (a) above, and shall be entitled to remove him from that office and to appoint any other person thereto from time to time.[46]

In the circumstances, the company may be treated as an FDI company in spite of such a low share of the foreign partners.

The above examples underline the need for case-by-case approach for ascertaining control. In this context, it may also be relevant to refer to the Securities and Exchange Board of India (SEBI) Takeover Regulations Advisory Committee which noted that

> ... given the case-specific nature of "control" as a concept, the Committee decided to refrain from stipulating whether the power to say "no" would constitute "control" for purposes of the Takeover Regulations. Whether a person has acquired control by virtue of affirmative rights would therefore have to be discerned from the facts and circumstances surrounding each case.[47]

2.3 Round-Tripping

Another important aspect of the global capital flows is the phenomenon of round-tripping which acquired prominence in the context of huge FDI inflows to China.[48] The OECD was of the view that

> Round-tripping refers to the channelling abroad by direct investors of local funds and the subsequent return of these funds to the local economy in the form of direct investment… [T]he simplest example of round-tripping occurs when a domestic investment is disguised as FDI through a subsidiary or associate located abroad, in the "routing economy" (i.e. the economy through which the funds are routed).[49]

In general, the OECD categorised direct investment enterprise to be of the round-tripping type if its ultimate investor belongs to the same economy.[50] Again, the OECD noted that, in practice, all transactions/positions between *fellow enterprises*[51] relate to the funds circulating within multinational groups via shared service centres or to take advantage of the best financing opportunities and that "(T)hey may also represent round-tripping of capital".[52] While China's round-tripping FDI is often discussed, in fact, because of flow of investments among group companies, even FDI into the USA has an element of round-tripping.[53]

The OECD identifies the main incentives for round-tripping as: *(i)* tax and fiscal advantages; *(ii)* property right protection; *(iii)* expectations on exchange control and exchange rate and; *(iv)* access to better financial services. As regards the last mentioned incentive,the OECD explains that since financial markets of some economies are not well developed, enterprises resident in these economies have to access overseas financial markets for better financial services, such as listing of companies in overseas stock markets. The funds raised will be brought back to host economies in the form of FDI. Round-tripping may occur as a part of this process. In order to give an idea of the true magnitude of FDI, the *Benchmark Definition* recommended separate supplementary breakdowns when this phenomenon affected significantly FDI data of a country.[54]

Round-tripping is important not only from the point of view of overstating of capital flows. As the OECD pointed out, some domestic companies may raise finances abroad and bring the same back into the national economy. In this case, though it would not amount to overstatement of capital flows, the flows do not carry with them the additional attributes of technology, management skills, marketing network, etc. Thus, the receiving enterprises would be like domestic enterprises irrespective of the level of 'foreign held equity'.

2.4 Indian Practice

From the above, it is evident that the choice of 10 per cent for determining FDI relationship has been more of a convenient thumb rule and that it has been adopted to maintain international comparability. The new approach was radically different from the one adopted in the past according to which foreign direct investments were identified on the basis of the control of enterprises by foreign investors. Thus, branches of foreign companies operating in India were obvious inclusions in this category. In addition, Indian joint stock companies were also regarded as controlled from abroad if either of the following two conditions were met:

(a) the foreign ownership was sufficiently large to bestow control over the affairs of the company; and/or

(b) there was an association or an agreement with the foreign owners by virtue of which control is vested (directly or indirectly) in them.[55]

Besides subsidiaries of foreign companies incorporated in India, the country's legal framework created three other categories of foreign controlled companies. These were companies *(i)* in which non-residents belonging to *one country* owned 40 per cent or more of the ordinary shares; *(ii)* in which 25 per cent or more of whose ordinary shares were owned by another foreign-controlled company in India; and *(iii)* those managed by foreign-controlled managing agents in terms of a managing agency agreement. The third category of companies ceased to exist after the Managing Agency system was abolished in 1969.

The Reserve Bank of India (RBI) conducted studies on the finances of the foreign controlled rupee companies (FCRCs) by including the first two categories of companies referred to above. Thus, RBI defined FCRCs as:

> Indian joint stock Companies which were subsidiaries of foreign companies, companies in which 40 per cent or more of the equity capital was held outside India in any one country and companies in which 25 per cent or more of the equity capital was held by a foreign company or its nominee were treated as Foreign-Controlled Rupee Companies (FCRCs).[56]

However, RBI discontinued the FCRCs survey after 1990-91 and replaced it with the surveys of Foreign Direct Investment (FDI) Companies. The FDI companies were defined in keeping with guidelines provided by the 5th edition of the Balance of Payments Manual:

> A direct investment enterprise is defined as an incorporated or unincorporated enterprise in which a direct investor, who is resident in another economy, owns 10 per cent or more of the

> ordinary shares or voting power (for an incorporated enterprise) or the equivalent (for an unincorporated). As such, a company in which 10 per cent or more equity capital is held by a *single non-resident investor* is defined as a Foreign Direct Investment Company. (emphasis added)[57]

As is clear from the foregoing, global integration of the Indian economy since 1991 was also accompanied by efforts at aligning the country's FDI reporting system with the international reporting system. This process was taken further following the recommendations of the RBI Committee on Compilation of Foreign Direct Investment in India in 2002. The upshot of this exercise was that the 10 per cent criterion was taken as the inviolable yardstick for determination of foreign control over an enterprise and all other aspects of FDI were ignored. One is not sure, how this has affected the quality of RBI's studies of "Finances of FDI Companies".[58]

The fact of unquestioned adherence to the 10 per cent criterion ignoring the context surrounding foreign direct investment was found to be problematic in many quarters. More significantly, the Economic Advisory Council to the Prime Minister in its Review of the Economy 2007-08 said:

> Inflows of Private Equity (PE) investments have also been quite large. Since in most cases PE flows constitute less than 10 per cent of the capital of the company being invested they should ideally be reported under Portfolio Capital, and not under FDI. *It is not clear what the current accounting practice is.* (emphasis added)

What gets clearly reflected in the above statement is the fact that an important official advisory body was unaware of certain aspects of computing FDI in India.

The thin line between FDI and foreign portfolio investments (by FIIs) as far as classification of foreign private equity and venture capital in India is further evident from the following observation of the Working Group on Foreign Investment set up by the Ministry of Finance.

> **Inflows into unlisted equity**: At a conceptual level, a private equity or venture capital fund outside India can invest in India in three ways. *First*, private investment in unlisted equity can take place if the foreign entity creates an investment vehicle which obtains an FII registration. *Second*, even without registering as an FII a private equity or venture capital fund outside India can invest in an Indian unlisted company up to the level of caps for FIIs. These investments would be treated as FDI, ... These two mechanisms, put together,

> characterize the main avenues for private equity/venture capital inflows into India. The *third* way for private equity or venture capital funds outside India to invest in the country is to register as an FVCI with SEBI and be regulated as such.[59] (emphasis added)

The Consolidated FDI Policy (CFP) issued by the Department of Industrial Policy and Promotion (DIPP) on 31 March 2010 and its predecessor the Draft Press Note (DPN) on FDI Regulatory Framework throw light on the way FDI is being measured in India. While reiterating the motivation of the direct investor as:

> ... a strategic long term relationship with the direct investment enterprise to ensure the significant degree of influence by the direct investor in the management of the direct investment enterprise,

the CFP further explained:

> Investment in Indian companies can be made both by non-resident as well as resident Indian entities. *Any non-resident investment in an Indian company is direct foreign investment.*[60] (emphasis added)

Interestingly, the DPN, issued earlier for discussion by the Government, stated that:

> In India the 'lasting interest' is not evinced by any minimum holding of percentage of equity capital/shares/voting rights in the investment enterprise.[61]

This suggests that all foreign investments (other than those purchased by FIIs on the stock market) in equity capital and equity related instruments are being treated as FDI *irrespective of the extent of foreign share*. It is obvious that in not all the cases there will be lasting interest and the ability or intention to significantly influence the management of the investee company. While this contrasts sharply with the 'international best practice', one cannot expect such FDI to be accompanied by the attendant attributes and deliver the perceived benefits from FDI. John Dunning's "eclectic theory of FDI", (often referred to as the OLI paradigm[62]) suggests that the foreign investor have several advantages over the domestic enterprises in order to compensate for the disadvantages associated with operating in an alien environment. Pure financial investments are less likely to be accompanied by such ownership advantages which the foreign investor would like to internalise.

In the backdrop of the internationally adopted criterion not being followed in practice, one may not expect round-tripping by domestic investors to be treated separately as a distinct category of capital flow other than FDI. In spite of the fact that some well-known companies which raised capital by

listing abroad have invested back in India and occasional reports in the press regarding some delayed or disapproved FDI proposals because of suspected round-tripping of funds, this phenomenon has never been explored fully in case of India.[63] A news report of 2003 attributed to RBI did, however, say that round-tripped FDI as a part of the total FDI was insignificant and could be as low as 2-3 per cent.[64]

Interestingly, Bain & Co., a major global business and strategy consulting firm, says:

> Employing another tactic, some domestic PE funds invest in Indian companies through wholly owned offshore subsidiaries. Because several jurisdictions, including Singapore and Mauritius, have double-taxed treaties with India, PE funds can use Special Purpose Vehicles based there to avoid transferability restrictions when they eventually exit from an investment.[65]

From the foregoing it is evident that besides the usual classification of market seeking, efficiency seeking, resource/strategic asset seeking FDI there are also categories that could be called "return seeking" and "round tripping" FDI. The last two, strictly speaking, cannot be equated with FDI. Thus, there is a case for analysing the reported FDI inflows, keeping in view the expectations from FDI, by suitably classifying the foreign investors. We shall, in the following, try to analyse India's FDI inflows from this perspective.

3. Analysis of Inflows

3.1 The Aggregates

As noted above, the reported stock of FDI in India increased substantially after the process of economic liberalization gained momentum. Table 4 presents the inflows data for the 11-year period 2000-01 to 2010-11. The data presented in the table are comparable since India adopted the international norms for presenting FDI statistics, alluded to in the earlier section, from 2000-01.[66] The change in the reporting practice which introduced new items, especially reinvested earnings of the already established enterprises, contributed significantly to the upward revision of total inflows. As compared to the earlier methodology, the new approach resulted in increasing FDI inflows by 44 per cent for the period 2000-01 to 2004-05 and nearly 31 per cent for the period 2005-06 to 2009-10. As can be seen from the Table, the dramatic rise in the inflows after 2005-06 was also a result of rapid increases in equity inflows (comprising of inflows on account of (i) government approvals, (ii) acquisitions and (iii) through the automatic route). The FDI Equity inflows during the five years 2005-06 to 2009-10 were almost seven times those of the previous quinquennium. (Chart 1)

Table 4: Reported FDI Inflows to India and their Main Components
(As per International Best Practices)

(US $ mn)

Financial Year (April-March)	Main Components: Equity Inflows (FIPB/SIA, Automatic & Acquisition Routes)#	Equity capital of unincorporated bodies ##	Re-invested earnings +	Other capital +	Total FDI Inflows	Share of new items in the total [(3)+(4)+(5)]/(6)x100
(1)	(2)	(3)	(4)	(5)	(6)	(7)
2000-01	2,339	61	1,350	279	4,029	41.95
2001-02	3,904	191	1,645	390	6,130	36.31
2002-03	2,574	190	1,833	438	5,035	48.88
2003-04	2,197	32	1,460	633	4,322	49.17
2004-05	3,250	528	1,904	369	6,051	46.29
2005-06	5,540	435	2,760	226	8,961	38.18
2006-07	15,585	896	5,828	517	22,826	31.72
2007-08	24,573	2,291	7,679	292	34,835	29.46
2008-09	27,329	702	9,030	777	37,838	27.77
2009-10(P) (+) (++)	25,609	1,540	8,669	1,945	37,763	32.18
2010-11(P) (+)	19,430	657	6,703	234	27,024	28.10
Memorandum Items						
1991-92@- 1999-00	15,483	-	-	-	15,483	
2000-01 to 2004-05	14,264	1,002	8,192	2,109	25,567	44.21
2005-06 to 2009-10	98,636	5,864	33,966	3,737	1,42,223	30.63
2000-01 to 2009-10	1,12,900	6,866	42,158	5,846	1,67,790	32.70

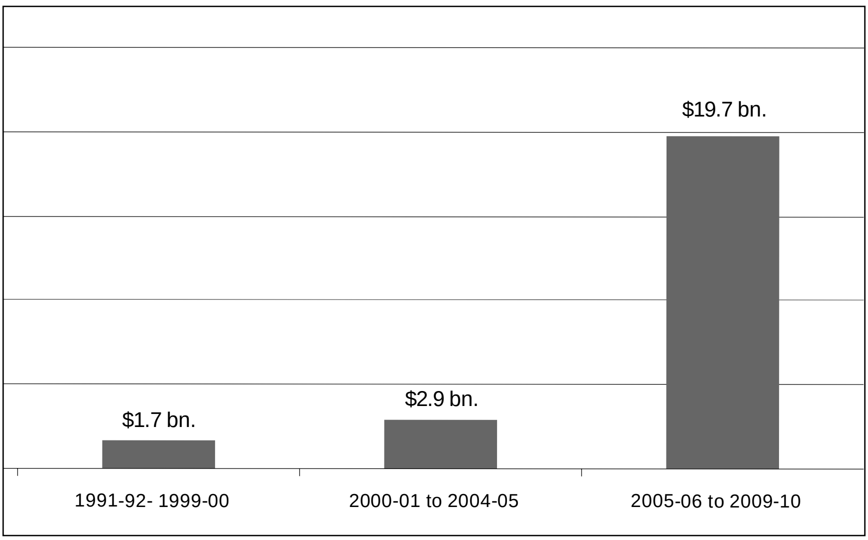
Source: Based on DIPP, "Fact Sheet on Foreign Direct Investment (FDI)", March 2011.
@ August 1991 to March 1992.
"+" (P) All figures are provisional and data in respect of 'Re-invested earnings' & 'Other capital' for the years 2009-2010 & 2010-11 are estimated as averages of previous two years.
++ Data on equity capital of unincorporated bodies, reinvested earnings and other capital pertains to the period from April 2009 to December 2009.
# Hereafter referred to as FDI Equity Inflows.
Figures for equity capital of unincorporated bodies for 2009-10 are estimates.

The increase in inflows since 2005 resulted from a number of policy initiatives taken by the government to attract FDI. In March 2005, the government announced a revised FDI policy, an important element of which was the decision to allow FDI up to 100 per cent foreign equity under the automatic route in townships, housing, built-up infrastructure and construction-development projects.[67] The year 2005 also witnessed the enactment of the Special Economic Zones Act, which opened further avenues for the involvement of foreign firms in the Indian economy.

Further, it can be seen from Table 5 that acquisition of shares of domestic enterprises by foreign investors contributed substantially to the FDI equity

inflows[68] and it peaked in 2005-06 and 2006-07 to reach almost two-fifths of the total FDI Equity flows. Acquisition of shares (which do not add to the existing facilities in the near term) together with reinvested earnings (which do not represent actual inflows) account for a substantial proportion of the reported total inflows: in some years even forming more than half of the total. (Chart 2) Another notable feature of the inflows is that the proportion of the inflows subject to specific government approvals declined from 62.25 per cent in 2000-01 to just 10 per cent in 2010-11 reflecting the extent of opening up and progressively greater freedom enjoyed by the foreign investors in making their investment decisions.

Chart 1: Annual Average Reported FDI Equity Inflows during Different Periods



Source: See Table 4.

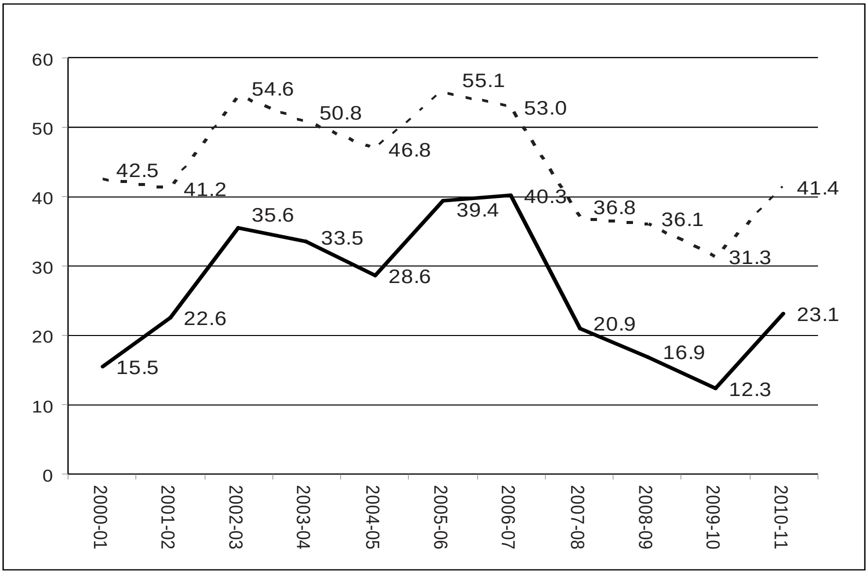
A development which provides a specific context to the present study is the sharp decline in the reported total FDI inflows during 2010-11 – by over 28.4 per cent over the inflows during 2009-10. The corresponding fall in FDI Equity inflows was 24.1 per cent. From Table 5 (and Chart 2) it can be seen that even this level of equity inflow was sustained by a sudden increase in the inflows through the acquisition route. From a share of 12.3 per cent in the FDI Equity inflows of 2009-10, its share doubled to 23.1 per cent in 2010-11. And it is the inflows through the automatic route which were affected substantially (fall of $6 bn,) rather than those through the Foreign Investment Promotion Board/Secretariat for Industrial Assistance (FIPB/SIA)

Table 5: Entry Route-wise Distribution of FDI Equity Inflows# in US $ mn

Year	Entry Route			Total (2)+(3)+(4)	Share in Total (per cent)		
	FIPB/ SIA	Auto-matic*	Acqu-isition of shares		FIPB/ SIA	Auto-matic	Acqui-sition of shares
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
2000-01	1,456	521	362	2,339	62.25	22.27	15.48
2001-02	2,221	802	881	3,904	56.89	20.54	22.57
2002-03	919	739	916	2,574	35.70	28.71	35.59
2003-04	928	534	735	2,197	42.24	24.31	33.45
2004-05	1,062	1,258	930	3,250	32.68	38.71	28.62
2005-06	1,126	2,233	2,181	5,540	20.32	40.31	39.37
2006-07	2,156	7,151	6,278	15,585	13.83	45.88	40.28
2007-08	2,298	17,127	5,148	24,573	9.35	69.70	20.95
2008-09	4,699	17,998	4,632	27,329	17.19	65.86	17.95
2009-10 (P)	3,471	18,990	3,148	25,609	13.55	74.16	12.29
2010-11 (P)	1,945	12,994	4,491	19,430	10.01	66.88	23.11

Source: Based on Table No. 44, *RBI Monthly Bulletin*, January 2011, p. S 86.
Excluding investments in Unincorporated Bodies, Reinvested Earnings and Other Capital.
(P): Provisional
* Includes small quantities on account of NRI investment for the years 2000-01 and 2001-02.

Chart 2: Relative Contribution of Reinvested Earnings and Acquisition of Shares to FDI Inflows



-------- Reinvested Earnings (Col.4 of Table 4) and Acquisition of Shares (Col. 4 of Table 5) as % of Total FDI Inflows (Col. 6 of Table 4).
——— Acquisition of Shares (Col. 4 of Table 5) as % of FDI Equity Inflows (Col. 5 of Table 5).

approval route (decline of $1.5 bn.) suggesting that more than the problems in getting the approvals through, it is the voluntary restraint on part of the foreign investors which was responsible for the slow down. The major fall in FDI inflows has caused concern in policy making circles and has become a subject matter of public comments.[69] RBI in particular is now worried about the fall in FDI inflows in the context of higher level of current account deficit and dominance of volatile portfolio capital flows. The volatile FII inflows which accounted for a substantial proportion of the equity flows have in turn contributed to the volatility in equity prices and the exchange rate. RBI underlined the 'sustainability risks' posed by the composition of capital flows and the need for recovery in FDI which is expected to have longer-term commitments.[70] Besides environmentally sensitive sectors like mining, integrated township projects and construction of ports, it identified the sectors responsible for the slow down as "construction, real estate, business and financial services".[71] It does appear that the role of FDI is now being seen more from the point of managing the current account deficit due to its more 'stable' nature,[72] rather than for it being a 'bundle of assets'.

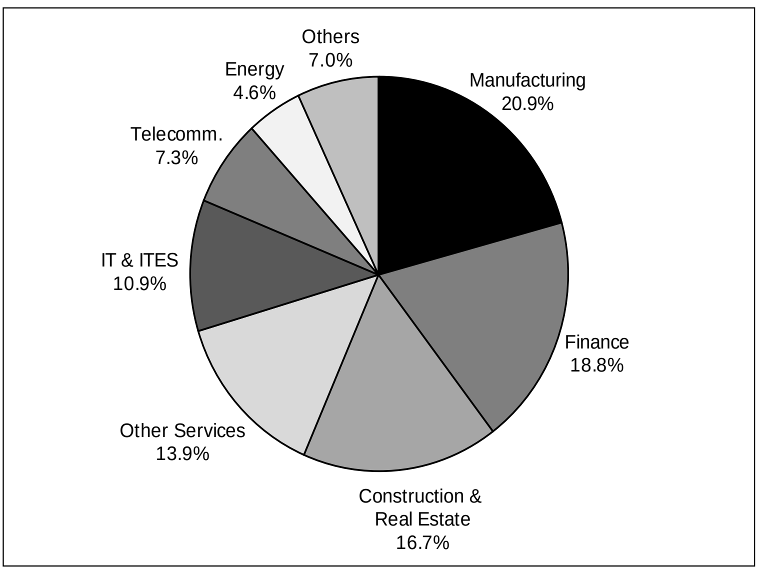
The increased inflows have been characterised by a sharp change in their sectoral composition. By 2008, while the share of manufacturing declined to almost half of what it was in 2005[73], share of services increased the maximum with mining and agriculture related activities receiving marginal amounts. Within services, construction and real estate sector gained the most. The financial services sector too gained in importance. Major setback was, however, experienced by the IT & ITES sector. While the energy sector gained relatively, telecommunication services managed to retain its share. Construction and real estate and finance are thus the major gainers in this period. (Table 6 and Chart 3) A further scrutiny of the data suggests that only a few of the Indian investee companies like Punj Lloyd, Soma Enterprises and Shriram EPC can be categorised as engineering and construction companies and the rest are developers-a few of these were engaged in setting up IT Parks and SEZs. A similar examination of the inflows to the financial sector suggested that close to 40 per cent of the inflows were into companies that serve the securities market suggesting that they do not directly contribute to the financing needs of the Indian businesses. These could be termed as adjuncts to the foreign portfolio investors. In 2009, the situation changed somewhat (Table 7). While the manufacturing sector gained marginally, the construction and real estate sector improved its position further to account for more than one-fifth of the inflows. IT & ITES slipped even further with a share of just 2.6 per cent of the total.

Table 6: Major Sector-wise Distribution of FDI Equity Inflows# during 2005-2008

Sector	2005-2008	2005	2006	2007	2008	2005-2008
(1)	(2)	(3)	(4)	(5)	(6)	(7)
Total Inflow (US $ mn)	64,423	4,354	11,119	15,921	33,029	64,423
of which,	(per cent Share in Total Inflow for the Year)					
Manufacturing	13,436	41.41	17.44	18.67	20.35	20.86
Finance	12,114	11.68	19.77	18.08	19.77	18.80
Construction & Real Estate	10,754	3.12	11.50	17.41	19.88	16.69
Other Services	8,915	11.31	20.22	10.74	13.52	13.84
IT & ITES	7,016	21.21	17.25	15.18	5.32	10.89
Telecommunications	4,737	3.64	8.37	6.72	7.80	7.35
Energy	2,933	1.44	2.26	3.69	6.15	4.55
Trading	1,367	0.65	0.76	3.62	2.05	2.12
Mining	488	0.15	0.03	2.65	0.17	0.76
Agriculture	136	0.21	0.01	0.75	0.02	0.21
Unclassified	2,529	5.19	2.39	2.50	4.96	3.93
Total		100.00	100.00	100.00	100.00	100.00

Source: Based on the data provided in *SIA Newsletter* (various monthly and annual issues).
Excluding those into Unincorporated Bodies, Reinvested Earnings and Other Capital

Chart 3: Sectoral Composition of Reported FDI Equity Inflows during 2005-2008



Source: See Table 6.

Table 7: Major Sector-wise Distribution of FDI Equity Inflows in 2009

Sector	Inflow (US $ mn)	Share in Total (%)
(1)	(2)	(3)
1. Services Sector	18,871.60	69.78
of which,		
- Housing, Real Estate & Construction	5,658.40	20.82
- Telecommunications	2,557.65	9.50
- Agriculture Services	1,307.37	4.84
- Information & Broadcasting - (including Print Media)	782.77	2.90
- Computer Software*	688.30	2.55
2. Manufacturing	5,791.21	21.41
of Which		
- Automobile Industry	1,338.38	4.94
- Electrical Equipments	787.56	2.91
- Metallurgical Industries	470.73	1.74
- Chemicals (other than Fertilizers)	451.36	1.69
3. Energy	2,137.60	7.90
4. Others	243.73	0.91
Total	27,044.14	100.00

Source: Based on data available in SIA Newsletter, January 2010.
Excluding those into Unincorporated Bodies, Reinvested Earnings and Other Capital.
* Following the previous year's distribution, the share of computer software within the broad classification of 'Computer Software & Hardware' has been taken approximately as 96 per cent.

Another important aspect of the inflows is the substantial shift in the immediate source country for FDI into India (Table 8). While the prominence of Mauritius for routing foreign capital to India has been well known, the more recent period witnessed further strengthening of Mauritius as the source country. For the period 2005 to 2009, the country accounted for practically half of the total reported inflows. Interestingly, Singapore secured the second position with Cyprus and UAE entering the group of top 10 home countries for FDI into India. Overall, countries categorised as tax havens accounted for much higher share of nearly 69.2 per cent of the total FDI inflows during the more recent period compared to their share of 39.5 per cent till 2000 or even 45.6 per cent in the immediate preceding period.

Table 8: India's FDI Equity Inflows*: Top 10 Home Countries Share (in percentage)

S. No.	Country	Aug. 1991 to Dec. 2000	2001 to 2004	2005 to 2009
	(1)	(2)	(3)	(4)
1	Mauritius	31.51	38.81	49.62
2	Singapore	2.76	2.22	11.33
3	U.S.A.	20.10	14.36	7.28
4	U.K.	5.44	7.80	5.64
5	Cyprus	0.20	0.18	4.41
6	Netherlands	5.19	9.48	3.83
7	Japan	7.41	7.32	3.22
8	Germany	5.61	4.13	2.61
9	U.A.E.	0.08	0.66	1.75
10	France	2.59	3.22	1.24
	Sub-Total	80.90	88.19	90.80
	Others	19.10	11.81	9.20
	Total FDI Inflows#	100.00	100.00	100.00
	Memorandum Items: Nature of Source Country			
	(i) Premier Tax Havens	7.57	6.27	18.79
	(ii) Mid-Range Tax Havens	31.94	39.26	50.29
	(iii) Minor & Notional Tax Havens	0.01	0.02	0.09
	Sub-total Tax Havens (i+ii+iii)	39.51	45.55	69.17
	(iv) Others	60.49	54.45	30.83
	Grand Total	100.00	100.0 0	100.00

Source: Based on the data provided in *SIA Newsletter* (various monthly and annual issues). Classification of home countries into Tax Havens is based on: (1) Tax Justice Network, *Closing the Floodgates: Collecting Tax to Pay for Development*, 2007, commissioned by the Norwegian Ministry of Foreign Affairs and (2) United States Government Accountability Office, *Large U.S. Corporations and Federal Contractors with Subsidiaries in Jurisdictions Listed as Tax Havens or Financial Privacy Jurisdictions*, December 2008.
* Excluding NRI investments and those for which country details have not been reported. The ranking is based on their position in 2005-09.

3.2 Analysis of Individual Inflows

To understand the above developments better, we now turn to data on individual inflows reported for the period September 2004-December 2009[74] and analyse these by the sector, home-country type and nature of inflow route. A crucial element added by us to the official data is classification of the foreign investors. To keep the exercise within manageable limits while also retaining its representative character, we have chosen all the inflows each amounting to US $ 5 mn or more.[75]

Out of the 29,233 reported inflows through *(i)* Foreign Investment Promotion Board (FIPB)/Secretariat for Industrial Assistance (SIA) approval route, *(ii)* automatic route and *(iii)* acquisition of existing shares of Indian companies by foreign investors covering an investment of US $ 92.36 bn (FDI Equity inflows), the relevant ones were 2,748. The 2,748 equity inflows accounted for $80.92 bn out of $92.36 bn or 87.61 per cent of the total inflows reported for the period by the SIA on its website. Since these are individual inflows and a company could have received inflows more than once during the period, we have tried to identify individual companies by taking into account name changes that have occurred. We could thus identify 1,659 recipient companies corresponding to these 2,748 cases of inflows.[76] One major lacuna of this data source is that it does not reveal the share of the foreign investor in the Indian investee company. Since only a few of the 1,659 companies were listed on the Indian stock exchanges, we could not independently ascertain the foreign shares in most cases.

From Table 9 it can be seen that the sectoral distribution of inflows represented by the top 2,748 cases broadly corresponds to the overall distribution presented in Table 6. Only about 15 per cent of the selected inflows were subjected to a formal approval process. Overall, about 21 per cent of the inflows were on account of acquisition of existing shares by foreign investors. This practice was, however, more prominent in the case of IT & ITES companies. A word of caution is, however, called for in interpreting the data on acquisitions as the inflows reported under this head could be under-representing the extent of acquisition of *existing businesses* by foreign investors in India.[77] The inflows reported under this category should reflect purchase of shares of companies incorporated in India in the *process of their takeover* by foreign companies. A few illustrative cases given in Annexure A show that the reported data does not uniformly reflect this process. For instance, the 2,748 large inflows selected by us for detailed examination have three entries relating to Cementrum BV's (Netherlands) investment in Mysore Cements Ltd. Two entries are reported as being under the Acquisition Route and the third under the Automatic Route. Possibly this is due to the fact that the former two relate to the transfer of existing shares of Mysore Cements to Cementrum and in case of the third one, newly created shares of Mysore Cements (expansion of capital) were issued to Cementrum.

There is also the possibility that when a division/unit of an existing company is taken over by a foreign company it may not always be reported as an acquisition by the same company. What appears to have been followed is that when the foreign investor bought the shares which were already held by another investor, it is treated as a case of acquisition and when new shares of the target are issued to the same foreign investor they are reported under the FIPB/SIA or Automatic Routes as the case may be. It is obvious that both types of inflows are

related to takeover of an Indian company/business. There could be justification for treating them differently if fresh shares are issued after a long gap when the foreign investor felt the need to infuse more funds to revive the business or expand it. Further, for a proper assessment of the M&A situation in India, it is essential to take note of the acquisition of specific business units of companies as distinct from takeover of the companies themselves. A few illustrative such cases involving foreign companies are listed in Table 10.[78]

Table 9: Sector and Entry Mode-wise Distribution of Top 2,748 Reported FDI Equity Inflows# during September 2004 and December 2009

	No. of Comp-anies	Inflow (US $ mn)	Share in Total (%)	Shares of Different Routes of Inflow (per cent)			
				FIPB/ SIA App-roval	RBI Auto-matic Route	Acqui-sition	Total
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Manufacturing	492	18,015	22.26	19.59	56.56	23.85	100.00
Services	1,084	54,739	67.65	14.81	65.87	19.32	100.00
Real Estate & Construction	382	14,526	17.95	2.85	88.68	8.47	100.00
Financial	194	13,974	17.27	18.96	64.60	16.44	100.00
IT & ITES	147	8,283	10.24	10.44	43.73	45.83	100.00
Telecommunications	25	6,292	7.78	29.58	58.72	11.70	100.00
Other Infrastructure	50	4,364	5.39	7.08	64.65	28.26	100.00
Research & Development	5	90	0.11	27.73	56.70	15.57	100.00
Other Services	281	7,209	8.91	27.50	54.92	17.58	100.00
Energy	75	6,251	7.72	3.57	81.06	15.37	100.00
Mining & Agriculture	8	1,911	2.36	1.23	30.01	68.75	100.00
Grand Total	1,659	80,915	100.00	14.68	64.13	21.19	100.00

***Source*:** Based on the actual inflows reported in the monthly issues of *SIA Newsletter*.
[#] Each amounting to US $ 5 mn or more.

While the manufacturing sector stood at the top with the largest number of companies, its share in the amount received was considerably lower. In terms of number of recipients, construction and real estate stood at the second position with as many as 382 companies. It is interesting to note that only a small proportion (2.85 per cent) of the foreign investment in construction and real estate sector entered through the formal approval route. The financial sector also has a relatively better position both with regard to the number of companies as also the inflows. While inflows to mining and agriculture sectors were subject to least approval mechanism, their share in the total was quite

low. The Energy sector is also largely free from initial approval process. R&D (excluding the companies covered in IT&ITES) attracted a miniscule share of the inflows represented by the 2,748 cases.

Table 10: Illustrative Cases of Business Unit Transfers to FDI Companies

Acquirer	Acquired Division of
Birla NGK Insulators Pvt Ltd	Jayshree Insulator unit of Indian Rayon. & Industries Ltd
EBG India Pvt Ltd (now Thyssen Krupp Electrical Steel India Pvt Ltd)	Steel division of Raymond Ltd
FCB - KCP Ltd	Sugar Machinery Division of KCP Ltd
KBX Motorbike Products Pvt Ltd	Kalyani Brakes' two-wheeler brake production
Kirloskar Copeland Ltd	Compressor manufacturing division of Kirloskar Brothers Ltd
Lafarge Aggregates & Concrete (I) Pvt Ltd	Concrete mix division of Larsen & Toubro Ltd
Lafarge India Pvt Ltd	Tata Steel's Cement Plant
Lafarge India Pvt Ltd	Cement division of Raymond Ltd
Lanxess India Pvt Ltd	Chemicals & wind power business of Gwalior Chemical Industries Ltd
Novozymes South Asia Pvt Ltd	Enzymes business of Biocon
Osram India Pvt Ltd	Lighting Davison of ECE Industries Ltd
Parry Monsanto Seeds Pvt Ltd	Seeds division of EID Parry India Ltd
Raymond UCO Denim Pvt Ltd	Denim unit of Raymond Ltd was transferred to the JV
Sinochem India Pvt Ltd	Butachlor and alachlor businesses of Monsanto India
South Asia Tyres Ltd	2 & 3 - wheeler tyre unit of Ceat.
Tecumseh Products India Pvt Ltd	Compressor manufacturing unit of Shriram group
Thyssenkrupp ECE Elevator Pvt Ltd	Elevator Division of ECE Industries Ltd
VE Commercial Vehicles Ltd	LCV unit of Eicher Motors Ltd
Vetoquinol India Animal Health Pvt Ltd	Animal healthcare business of Wockhardt Ltd

In order to further understand the nature of reported FDI inflows, which could indicate the possible behaviour of the foreign investors and their contribution to enterprise development, we have classified the foreign investors into different categories keeping in mind the discussion on concepts presented in Section 2. The classification heavily relied upon information gathered from websites of companies, newspapers, professional bodies, consultants, investment advisers, etc. as also the ISID Press Clippings archives. Foreign companies which invested in their own area of functioning irrespective of the sector they are engaged in have been categorised as FDI investors.[79] This is because an investor investing in his own line of activity *could directly contribute* to the functioning of the investee company. Since it was not possible to get the foreign share in each of the companies, all those cases were uniformly treated as FDI. Since there could be some passive investments, our estimate of FDI could be on the higher side. All individual investors whose names suggest that they could be of Indian origin and companies known to have been promoted by them are termed as NRIs. Investments by banks and other financial intermediaries (unless these are in their own respective sectors) are termed as Other Portfolio investments as the main objective of such investments could be capital gains and they on their own may not be able to add directly to the functioning of the domestic investee company. For instance, a bank investing in a manufacturing company is identified as a portfolio investor (for example, investments of HSBC Bank and Royal Bank of Scotland in Reliance Ports and Terminals Ltd). This is because their involvement could at best be like a financial investor who (whether domestic or foreign) might seek representation on the recipient company's board in case of substantial investments. The same, however, is classified as FDI in case the recipient Indian entity is a bank. Other portfolio investors known to be in the private equity/venture capital activity, hedge funds or sovereign wealth funds (SWF) have been classified as PE/VC/HF investors.[80] There have been some important cases where no specific information was available from any source. The classification of such investments took into account the circumstances of the investment and as such there could be some subjective element.[81]

Inflows by those who have their main base in India and who have expanded out of India have been treated as cases of Round-tripping. This is irrespective of whether the money brought in by them is raised abroad from other investors, might have been taken out from India by them at some point in the past or generated out of their past foreign investments. In a way this is expected to reflect the fact that control over the investee company remains with Indians who have strong base in India and except for capital inflow there would not be any additionality in terms of foreign management expertise, technology, etc.

Apart from the well-known cases of Essar group, Zee Tele group and Vedanta/ Sterlite group, we could identify some more with the help of internet. For instance, Biometrix Marketing Pvt Ltd of Singapore is a subsidiary of Reliance Genemedix PLC (which the Reliance Life Sciences group took over in early 2007). In view of this, the investments of Biometrix in Reliance Ports & Terminals Ltd, Relogistics Infrastructure, Reliance Utilities Ltd and Reliance Gas Transportation Infrastructure Ltd have been put under the round-tripping category by us. The investments by Ballarpur Paper Holding BV and NQC Global (Mauritius) Ltd in Bilt Graphic Paper Products Ltd and Bilt Paper Holdings Ltd respectively were also placed in this category. Similar is the case with the investments by Ishaan Real Estate and Unitech Corporate Parks (See Annexure B for an illustrative list and Annexures C1, C2 & C3 for diagrammatic representation of three sets of companies).[82] We have also classified the investment of Hitech Infra Ltd (Mauritius) in Krishnapatnam Port Co Ltd (KPCL) as a case of Round-tripping.[83]

It is relevant to underline here that a good number of companies listed on the London Stock Exchange which have operations in India and which appear to be controlled by Indians are registered in tax havens. (Table 11) some of these in turn have set up SPVs in Mauritius to invest in India. While we do not know how the shareholding of the founders was financed, in a few cases institutional investors appear prominently in the list of shareholders. To that extent, it suggests that FII funds instead of coming directly into the Indian stock market, in which case they would have been classified as portfolio capital, are coming via the LSE listed companies into India as FDI. Had they subscribed to GDR/ADRs of Indian companies, the funds would again have been classified as foreign portfolio inflows. This was the case with some other non-Indian controlled LSE listed companies as well. As we shall see later, since a good part of such inflows was not subjected to the FIPB/SIA route, one could say that it is neither subjected to FII nor FDI regulations.

Going by the foregoing criteria, out of the total $81 bn inflows under study less than half can be termed as FDI. The next most important category is PE/VC/ HF with almost 27 per cent share in the total followed by the Round-tripping variety with a share of about 10 per cent. It needs to be specified here that Round-tripping investments which also have the characteristics of PE/VC/HF have been clubbed with total PE/VC/HF investments. If these are also taken into account, the share of Round-tripping investments will work out to about 14 per cent of the total. Other portfolio investments work out to a little more than 9 per cent and NRI investments, some of which can be termed as portfolio investments, are about 5 per cent of the total. What strikes one most is that PE/ VC/HFs were more important in case of the services sector compared to the

Table 11: London Stock Exchange Listed Companies whose Control Appears to be with Indians and which Invested in India

Company	Country of Incorporation	Activity	Listing Date
(1)	(2)	(3)	(4)
West Pioneer Properties Ltd	British Virgin Islands	Real Estate Holding & Development	13-12-2006
India Hospitality Corp	Cayman Islands	Restaurants & Bars	24-07-2007
Indus Gas Ltd	Guernsey, Channel Islands	Exploration & Production	06-06-2008
Skil Ports & Logistics Ltd	Guernsey, Channel Islands	Transportation Services	07-10-2010
IEnergizer Ltd	Guernsey, Channel Islands	Business Support Services	14-09-2010
Greenko Group PLC	Isle of Man	Alternative Electricity	07-11-2007
DQ Entertainment PLC	Isle of Man	Broadcasting & Entertainment	18-12-2007
Eros International PLC	Isle of Man	Broadcasting & Entertainment	04-07-2006
KSK Power Ventur PLC *	Isle of Man	Electricity	31-03-2010
OPG Power Venture PLC	Isle of Man	Electricity	30-05-2008
Dhir India Investments PLC	Isle of Man	Equity Investment Instruments	12-07-2007
Elephant Capital PLC	Isle of Man	Equity Investment Instruments	25-04-2007
Hirco PLC	Isle of Man	Real Estate Holding & Development	13-12-2006
Ishaan Real Estate PLC	Isle of Man	Real Estate Holding & Development	24-11-2006
Unitech Corporate Parks PLC	Isle of Man	Real Estate Holding & Development	20-12-2006
Jubilant Energy N.V.	Netherlands	Exploration & Production	24-11-2010
Photon Kathaas Productions Ltd	Singapore	Broadcasting & Entertainment	04-11-2010
Mortice Ltd	Singapore	Business Support Services	15-05-2008
Essar Energy PLC *	UK	Integrated Oil & Gas	07-05-2010
Vedanta Resources *	UK (Parent in Bahamas)	General Mining	10-12-2003

Except for those marked with an asterisk (*) which are listed on the UK Main Market, all are listed on the Alternative Investment Market (AIM) of the London Stock Exchange.

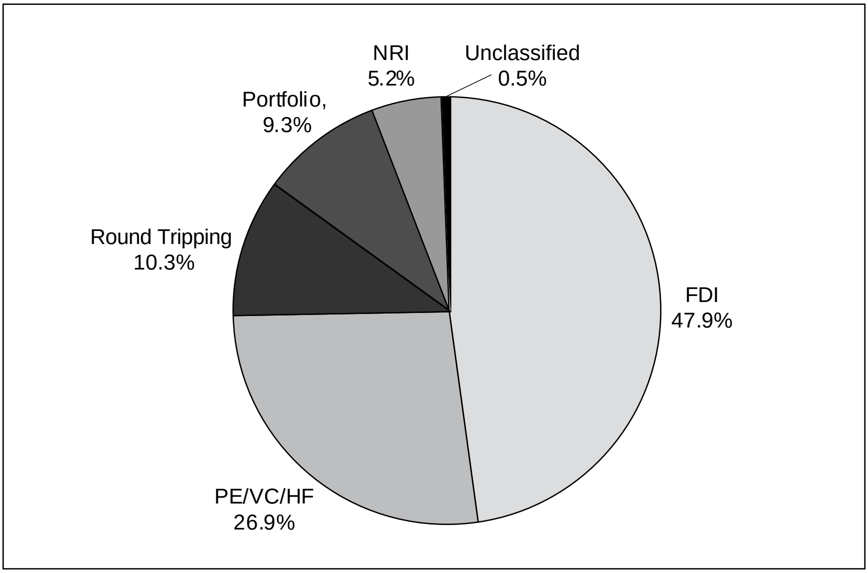
manufacturing sector (Table 12 and Chart 4). Within the services, they were more important for the construction and real estate sector. What could be termed as FDI accounts for only 13 per cent of the inflows into this sector.[84] This sector's inflows are also important for Round-tripping investment. Most of the investment in the telecommunications sector is in the form of FDI. Understandably, the R&D sector (excluding the IT&ITES) received investment only from two types of investors: either FDI or PE/VC/HF. Other infrastructure sectors depended heavily on portfolio or Round-tripping investment. In a way, this might be suggestive of the position that in most of the infrastructure sectors foreign investment offered little except for financial resources. The financial sector too was exposed to a large proportion of PE/VC/HF investments and portfolio capital.

Table 12: Sector and Type of Foreign Investor-wise Distribution of Top 2,748 Equity Inflows

Sector	Total Inflow (US $ mn)	Share of Different Types of Foreign Investors (per cent)						
		FDI	PE/ VC/ HF #	Round Tripping Only	Other Portfolio	NRI	Uncla-ssified	Total
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Total	80,915	47.85	26.91	10.30	9.25	5.22	0.48	100.00
A. Manu-facturing	18,015	61.57	15.48	8.05	8.82	5.47	0.61	100.00
B. Services	54,739	44.06	31.80	9.85	8.51	5.28	0.49	100.00
Construction & Real Estate	14,526	12.82	58.17	13.25	9.77	4.43	1.56	100.00
Financial	13,974	58.70	29.09	2.62	5.11	4.28	0.21	100.00
IT & ITES	8,283	61.35	19.95	1.19	2.85	14.66	0.00	100.00
Telecomm-unications	6,292	80.75	7.66	7.80	3.79	0.00	0.00	100.00
Other Infrastructure	4,364	14.11	13.15	38.19	29.60	4.96	0.00	100.00
Research & Development	90	56.87	43.13	0.00	0.00	0.00	0.00	100.00
Other Services	7,209	44.72	29.79	11.71	10.55	3.03	0.19	100.00
C. Energy	6,251	36.08	18.72	20.47	19.10	5.52	0.10	100.00
D. Mining & Agriculture	1,911	65.42	21.43	11.16	1.99	0.00	0.00	100.00

Source: See Table 9.
includes investment that could be categorised as round-tripping.

Chart 4: Type of Investor-wise Distribution of Top 2,748 Equity Inflows



Source: See Table 12.

While FDI accounted for less than half of the total inflows studied, only a little more than one-fourth of it went into the manufacturing sector which means that manufacturing FDI accounted for just about 14 per cent of the total reported inflows during the period. (Table 13) A good percentage of it went into Financial services (21.19 per cent), IT&ITES (13.12 per cent) and telecommunications (13.12 per cent). Important recipients of portfolio capital are manufacturing (21.25 per cent), construction and real estate (18.97 per cent), other infrastructure (17.26 per cent) and energy (15.96 per cent). Construction and real estate sector had the lion's share of investments by PE/VC/HFs with 38.8 per cent share followed by financial services with 18.67 per cent. The manufacturing sector received 12.81 per cent of their investment. Prominent recipients of round-tripping investment are construction and real estate (23.10 per cent), other infrastructure (20 per cent) and energy (15.22 per cent). While 80 per cent of the PE/VC/HF investment is in the services sector, construction and real estate alone accounted for 38.80 per cent of the total followed by the financial sector with 18.67 per cent. Though *total* Round Tripping investments were slightly more evenly distributed compared to PE/VC/HF investments, nearly 70 per cent of it is in services with construction and real estate alone claiming one-third. Interestingly, 60 per cent of the investment that could simultaneously be classified as both PE/VC/HF and Round-tripping went into the construction and real estate sector (Chart 5).

Interestingly, almost three-fourths of the PE/VC/HF capital which is a prominent source for the construction and real sstate sector, came through the automatic route. A further 17 per cent followed the acquisition route with only about 9 per cent being subjected to government approval. (Table 14 and Chart 6) Similar is the case with the inflow that could be termed as Round-tripping. One-third of the Other Portfolio capital took the acquisition route thereby suggesting that much of it was not adding to the existing investment. In any case, it is unlikely to be interested in/capable of directly contributing to enhance the functioning of the investee companies. While the proportion of inflows that are subject to a formal approval process is generally low, the proportion surprisingly is the highest for FDI. It does appear that an overwhelming portion of the foreign investment made under categories other than FDI does not go through a formal approval process. At 36 per cent, non-acquisition type FDI accounts for only a shade over one-third of the total reported equity inflows.

Table 13: Sectoral Distribution of Various Types of Top 2,748 Equity Inflows

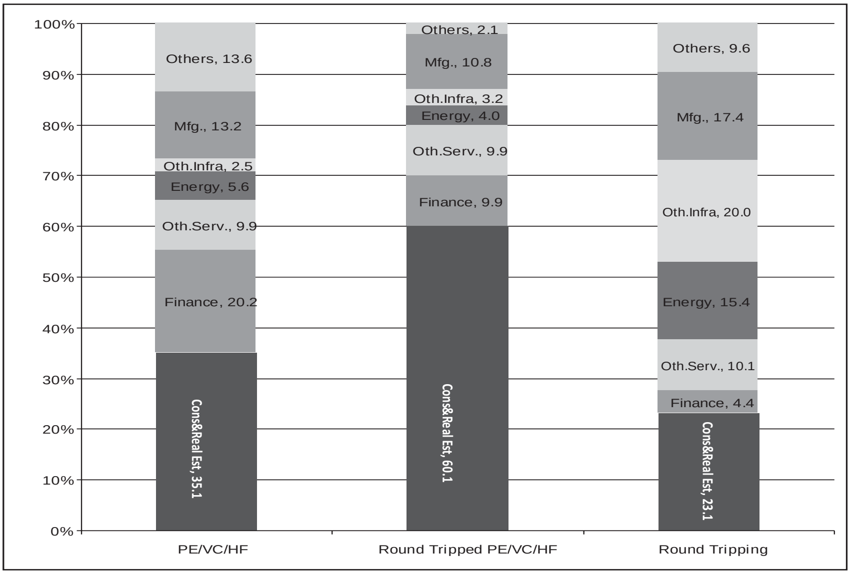
(Percentages)

Sector	FDI	Port-folio	PE/VC/HF (excl. Round Tripping)	Round Tripped PE/VC/HF	Round Tripping (excl. PE/VC/HF)	Round Tripping Total	NRI
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
A. Manufacturing	28.65	21.25	13.15	10.84	17.40	15.56	23.35
B. Services	62.30	62.29	79.02	85.19	64.69	70.45	68.48
Construction & Real Estate	4.81	18.97	35.06	60.11	23.10	33.49	15.25
Financial	21.19	9.54	20.21	9.85	4.39	5.92	14.16
IT & ITES	13.12	3.16	8.61	1.75	1.18	1.34	28.77
Telecomm-unications	13.12	3.19	2.53	3.23	5.89	15.29	0.00
Other Infra-structure	1.59	17.26	2.53	0.38	20.00	4.34	5.12
Research & Development	0.13	0.00	0.21	0.00	0.00	0.00	0.00
Other Services	8.33	10.17	9.86	9.88	10.13	10.06	5.18
C. Energy	5.83	15.96	5.62	3.96	15.36	12.16	8.18
D. Mining & Agriculture	3.23	0.51	2.21	0.00	2.56	1.84	0.00
Total	100.00	100.00	100.00	100.00	100.00	100.00	100.00

***Source*: See Table 9.**

Note: Unclassified ones are not shown here.

Chart 5: Sectoral Composition of Private Equity and Round-Tripped Investments



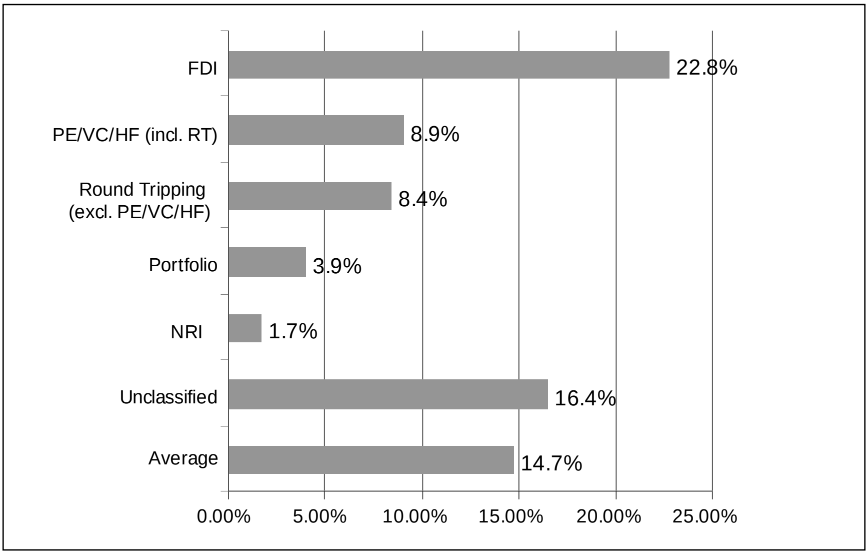
Source: See Table 13.

Table 14: Foreign Investor-wise and Entry Route-wise Distribution of the 2,748 Equity Inflows

Type of Foreign Investor	Total Inflow ($ mn)	Share in Total (per cent)			
		FIPB/SIA Approval	RBI Automatic	Acqu-isition	Total
(1)	(2)	(3)	(4)	(5)	(6)
FDI	38,717	22.77	52.99	24.25	100.00
Portfolio	7,481	3.89	62.55	33.56	100.00
PE/VC/HF (incl. RT)	21,778	8.94	74.07	17.00	100.00
Round Tripping (excl. PE/VC/HF)	8,333	8.35	73.70	17.95	100.00
NRI	4,222	1.65	97.12	1.23	100.00
Unclassified	385	16.39	83.61	0.00	100.00
Grand Total	80,915	14.68	64.13	21.19	100.00

Source: See Table 9.

Chart 6: Share of Inflows subjected to Specific Government Approvals for Different Types of Equity Inflows



Source: See Table 14.

An important and well-recognised dimension of India's FDI inflows is the fact of foreign investors' extensive use of recognized tax havens for entry into India. Table 15 (and Chart 7) presents the use of such countries by different categories of foreign investors. In a number of cases, predominantly NRIs and acquisition cases, the data source did not report the country of the foreign investor. For purposes of this exercise, such cases had to be excluded. While in the overall, the share of tax havens conforms to the general pattern, it is apparent that the route is exploited more by investors under the PE/VC/HF and Round-tripping categories. Further from Table 16 (and Chart 8) it can be seen that telecommunications, construction and real estate activities as also IT/ITES extensively used the tax havens which by all indications could not be the primary home countries. Manufacturing and energy sectors used this route to the least extent. Practically the entire amount that is Round-tripped by Indian PE/VC/HF investors came through tax-havens as indicated by Bain & Co and cited in Section 2.

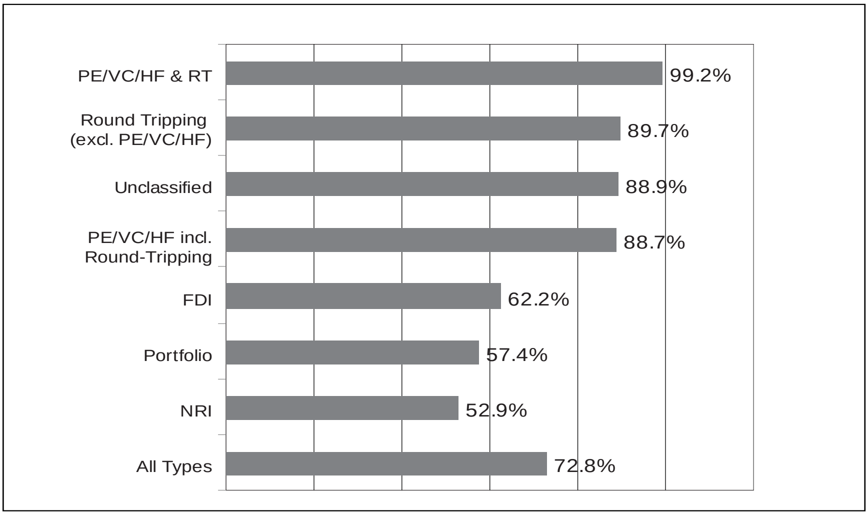
Table 15: Type of Foreign Investor-wise and Source Country Type-wise Distribution of the 2,748 Equity Inflows

Type of Foreign Investor	Total Inflow ($ mn)	Of which		Share of Different Types of Source Countries (per cent) (classified investments only)			
		Classi-fied*	Unidenti-fied	Premier Tax Havens	Other Tax Havens	Other Countries	Total Classi-fied
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
FDI	38,717	34,874	3,843	15.93	46.27	37.80	100.00
Portfolio	7,481	4,552	2,929	25.73	31.67	42.60	100.00
PE/VC/HF incl. Round-Tripping	21,778	20,985	793	15.84	72.86	11.30	100.00
PE/VC/HF & RT	3,252	3,134	98	7.23	91.99	0.78	100.00
Round Tripping (excl. PE/VC/HF)	8,333	7,508	825	30.07	59.59	10.34	100.00
NRI	4,222	1,444	2,778	50.94	1.98	47.07	100.00
Unclassified	385	375	10	40.16	48.75	11.09	100.00
Grand Total	80,915	69,737	11,179	18.92	53.85	27.23	100.00

Source: See Table 9.

* Excluding the cases where the country of the foreign investor was not identified. These mostly involved the acquisition of existing shares and NRIs. For the basis of country classification, see: Table 8.

Chart 7: Share of Tax Havens in Equity Inflows by Different Types of Investors



Source: See Table 15.

Table 16: Sector-wise and Source Country Type-wise Distribution of Equity Inflows

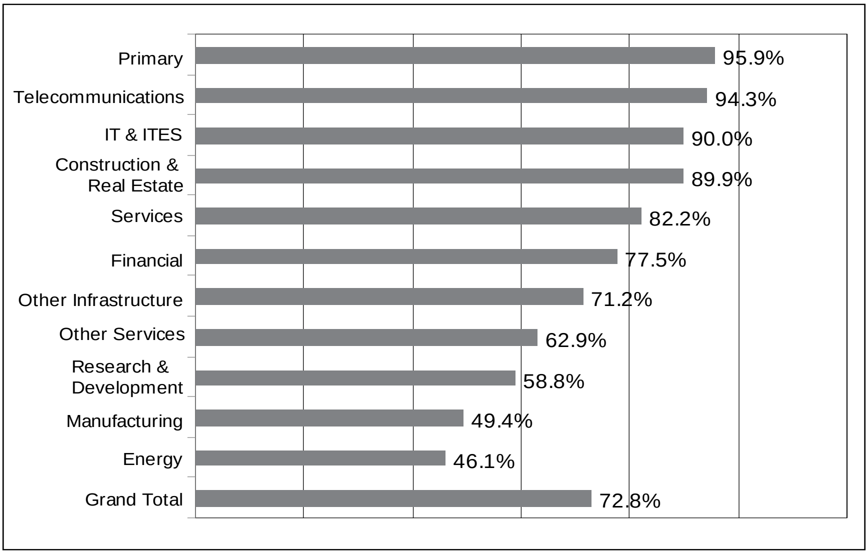
Sector	Identified Inflows * ($ mn)	Share of Different Types of Source Countries (per cent)			
		Premier Tax Havens	Other Tax Havens	Other Countries	Total
(1)	(2)	(3)	(4)	(5)	(6)
Manufacturing	14,484	17.15	32.21	50.64	100.00
Services	49,399	19.72	62.51	17.78	100.00
Construction & Real Estate	13,256	15.71	74.19	10.10	100.00
Financial	12,683	23.12	54.38	22.50	100.00
IT & ITES	7,481	17.13	72.83	10.03	100.00
Telecommunications	5,742	9.39	84.90	5.72	100.00
Other Infrastructure	3,516	48.33	22.90	28.77	100.00
Resecarch & Development	90	0.00	58.76	41.24	100.00
Other Services	6,630	18.17	44.71	37.12	100.00
Energy	5,283	11.10	34.96	53.94	100.00
Primary	572	67.19	28.68	4.12	100.00
Grand Total	69,736	18.92	53.85	27.23	100.00

Source: See Table 9.

* Excluding the cases where the country of the foreign investor was not identified. These mostly involved the acquisition of existing shares and NRIs.

For the basis of country classification, see: Table 8.

Chart 8: Share of Tax Havens in the Equity Inflows of Different Sectors



Source: See Table 16.

3.3 Other Aspects

Apart from these broad but important characteristics of the inflows, we did come across certain aspects of the reported inflows which suggest that the reported inflows may not strictly conform to the international practice of identifying an FDI relationship. For instance, some of the reported inflows into listed companies did not appear among the shareholders with at least 1 per cent shareholding either because they had already withdrawn their investment or their share (either initially or remaining at the end of December 2008) amounted to less than 1 per cent of the investee company's equity capital.[85] Further evidence to the fact that not all inflows would qualify to be FDI in the sense that is normally understood is provided in Table 17 and Table 18. The foreign investors shown in Table 17, most of which are evidently investment companies/fund managers, do not qualify as FDI even on the basis of the percentage of shares held by them. We have classified these investments under PE/VC/HF or portfolio categories as the case may be. It would be difficult to visualize that 'Various FIIs' and NRIs would exhibit the characteristics associated with foreign direct investors. Similar is the case with the individuals shown in Table 19 who probably subscribed to the shares of a housing project. It is highly unlikely that anyone of them would be holding a stake that would exert significant influence on the management of Home Sweet Home Developers Ltd.

Further, irrespective of the perspective regarding PE/VC/HF investments, it is difficult to visualize the types of inflows shown in Tables 18 and 19 and the ESOPs given to the employees of HCL Technologies Ltd, as FDI. Even going by the internationally adopted criteria all these inflows should have been treated as portfolio capital. This opens up a critical aspect of reporting of FDI data in India. Irrespective of the share of such inflows in the total reported FDI, these examples are important because they illustrate that India has not been looking for the critical aspects of internationally propagated FDI definition in classifying the inflows. While international best practices are sought to be followed, the critical aspects of minimum qualifying share in equity capital, ability to significantly influence management and lasting interest are not being taken into consideration while compiling India's FDI statistics. This was evident from the discussion presented in Section 2.4.

Table 17: Reported FDI Inflow into Some Listed Companies

Indian Company	Foreign Investor	Inflow Route & Month and Year of Reporting	Share (%) in Equity Capital as on 31-12-2008
(1)	(2)	(3)	(4)
ABG Shipyard Ltd	Merlion India Fund I Ltd	R-Oct.2005	8.76
Allcargo Global Logistic Ltd	New Vernon Pvt Equity Ltd	R-Oct.2006	3.81
Anant Raj Industries Ltd	Master Trust Bank of Japan Ltd. A/c HSBC Indian Equity Mother Fund	R-Apr-Sep. 2006	1.36
Anant Raj Industries Ltd	Quantum (M) Ltd	R-Apr.2008	1.50
Anant Raj Industries Ltd	Lehman Brothers Asia Ltd	R-Apr-Sep.2006	1.82
Bharat Hotels Ltd	Dubai Ventures Ltd	R-May.2008	5.00
Dalmia Cement (Bharat) Ltd	Boron (I) Ltd	R-Oct.2006	4.42
Development Credit Bank Ltd	GRA Finance Corpn. Ltd.	R-Dec.2007	1.87
Edelweiss Capital Ltd	Lehman Brothers Netherlands Horizon BV	R-Feb.2008	1.80
Edelweiss Capital Ltd	Shuaa Capital Psc	R-Feb.2008	2.20
Hexaware Technologies Ltd	GA Global Investments Ltd	R-Nov.2007	7.36
Indiabulls Financial Services Ltd	Deutsche Bank Trust Company	R- Aug.2005	1.31
Jindal Poly Films Ltd	SAIF II Mauritius Co Ltd	AC-Apr-Sep. 2006	6.66
JK Paper Ltd	International Finance Corp	R-Apr-Sep.2006	9.84
Jubilant Organosys Ltd	GA European Investments Ltd	AC-Jul.2005	7.93
KPR Mill Ltd	Ares Investments	R-Feb.2007	6.78
Punj Lloyd Ltd	Merlion India Fund III Ltd	R-Dec.2005	3.19
Sarda Energy & Minerals Ltd	LB India Holdings Mauritius Ii Ltd	R-Mar.2008	7.73
Torrent Pharmaceuticals Ltd	GPC Mauritius	AC-Oct.2007 & AC-Jan.2008	4.83
Yes Bank Ltd	Orient Global Tamrind Fund Pte Ltd	R-Apr.2008	4.95

***Source*:** Company-wise details of FDI inflows reported in the *SIA Newsletter*, various issues. The shares in equity capital of the respective companies shown in column (4) are taken from the Bombay Stock Exchange website.

In Column (3) 'R' indicates that the inflow was through the Automatic Route and 'AC' indicates the Acquisition of existing shares by the foreign investor.

Table 18: Illustrative List of Reported Equity Inflows which do not Qualify as FDI

Indian Company	Foreign Investor	Reporting Month #	Inflow Rs. (Cr.)
(1)	(2)	(3)	(4)
Akruti Nirman Ltd	Various	Apr.2007	155.34
Arshhiya Technologies	Various FIIs	May2008	350.00
Bajaj Auto Finance Ltd	Various	Oct.2007	157.50
Bajaj Auto Finance Ltd	Various NRIs	Dec.2007	126.48
Bharat Earth Movers Ltd	42 FIIs	Jan.2008	147.15
Gitanjali Gems Ltd	Various NRIs/FIIs	Nov.2007	109.11
Hindalco Industries Ltd	Various	Feb.2008	666.58
Hindustan Oil Exploration Co Ltd	Various NRIs/FIIs	Sep.2008	220.36
Housing Development & Infrastructure Ltd	Various	May2008	706.67
IRB Infrastructure Developers Ltd	Various IPO	Sep.2008	476.61
Kotak Mahindra Bank Ltd	Various	Feb.2008	1,615.00
Mahindra & Mahindra Ltd	Various FFI,FC, FFI	Ap Sep.2006	260.63
Mahindra Gesco Developers Ltd	Various	Jun.2007	324.08
Mercator Lines Ltd	Various FIIs	May2008	196.97
Mercator Lines Ltd	Various NRIs	May2008	21.56
Mundra Port and SEZ Ltd	Various NRIs/FIIs	Feb.2008	710.57
Panacea Biotec Ltd	As Per List Attached	Nov.2006	118.31
Panacea Biotec Ltd	As Per List	Nov.2006	101.59
Phoenix Mills Ltd	Various FIIs	Dec.2007	317.72
Reliance Communications Ltd	Various FIIs	May2008	845.48
Sterlite Industries Ltd	Various NRIs	Oct.2007	1,667.64
Tata Consultancy Services Ltd	Group of Non-Resident	Mar.2006	2,148.61
Tech Mahindra Ltd	Various	Jul.2007	171.97
Welspun Gujarat Stahl Rohren Ltd	Various FIIs	Feb.2008	302.15
Zee Telefilms Ltd	Various Investors	Apr.2008	152.49

***Source*:** Company-wise details of FDI inflows reported in the *SIA Newsletter*, various issues.

All these inflows were through the Automatic Route.

Table 19: Reported Equity Inflows on account of Home Sweet Home Developers Ltd.

Name of the Foreign Investor	Inflow (Rs. mn)	Name of the Foreign Investor	Inflow (Rs. mn)
Archana Vadya	0.01	Satya Kavachri	0.01
Ashish Srivastava	0.01	Satya Simha Prasad	0.01
Baiju Anand G Nair	0.01	Senthil Palanisamy	0.01
Brajesh Goyal	0.01	Shiddalingnagouda Rati	0.01
C.Sivanandan	0.01	Srikanth Patibanda	0.01
Devi Prasad Ivaturi	0.01	Srikumar Gopakumar	0.01
Eswar Vemulapalli	0.01	Srinivasu Sudireddi	0.01
Jayakrishnan Radhakrishnan	0.01	Srinvasa R Gaddamadugu	0.01
Krishna Kumar Vavilala	0.01	Sukir Kumaresan	0.01
Lakkoji	0.01	Venkateshwarlu Ravikant	0.01
Leela Prasad Koneru	0.01	Vijaya Kumar Christopher	0.01
Nakkapalli Veera Sekhar Babu	0.01	41 Non Resident Indians	0.21
Nirupama Henjarappa	0.01	Six NRI's One share each	0.03
Pradeep Shantaram Bhat	0.01	Six NRIs 1 share each	0.03
Raghu Bharadvaj	0.01	Ravi Kanth V.	0.01
Rama Murthy Setty	0.01	Suman Vijayagopal	0.01
Ramesh Babu Doddi	0.01	1.Srivamsi Madhwapthy 2.Ravi Mikkilineni	0.01
Ramesh Babu Vusirikala	0.01	Padmanabha C.J.	0.01
Ranganatha Bande	0.01	Raju Nunna	0.01
Sangeeth Omanama	0.01	Ramesh Racheria	0.01

***Source*:** Inflow details reported in the *SIA Newsletter*, various issues of 2006.

Merely looking for 10 per cent share of a *single foreign shareholder* for identifying an FDI company, which the RBI seems to have followed for its studies on Finances of FDI Companies, without taking into consideration that the same could be a portfolio investor (including an FII) opens up the possibility of classifying the companies listed in Table 20 as FDI companies. It would be difficult to visualise that these can exhibit the characteristics associated with an FDI company and that the foreign shareholder would contribute anything more than risk capital (if the shares were acquired in the secondary market, even that contribution cannot be counted upon). In fact, assuming that PE/VC/HF investors would exercise management control an appropriate question to ask would be whether one could distinguish between such foreign and domestic investors in terms of their management inputs and contribution to the performance of the domestic company. Interestingly, Hymer had pointed out that such foreign investors seek control over the enterprise in order to ensure the safety of their

Table 20: Companies which could be Classified as FDI Companies by the 10 per cent Criterion

Name of the Indian Company	Name of the Foreign Investor holding 10 % or more in Equity	Share in Equity (%)
(1)	(2)	(3)
Alfa Transformers Ltd	Strategic Venture Fund Mauritius, Venture Fund	14.93
Apollo Hospitals Enterprises Ltd	Apax Mauritius FDI One Ltd, a PE Company	11.41
Binani Cement Ltd	JP Morgan Special Situations Mauritius Ltd	11.59
Hindustan Sanitaryware & Inds. Ltd	HPC Mauritius Ltd, investment management co.	14.99
Infotech Enterprises Ltd	GA Global Investments Ltd, investment management Co.	12.86
IOL Chemicals & Pharmaceuticals Ltd	India Star Mauritius Ltd, a PE Company	14.80
Kanoria Chemicals & Industries Ltd	International Finance Corp (IFC), World Bank's private sector investment arm	10.84
Max India Ltd	Parkville Holdings Ltd, a Warburg Pincus co.	12.83
Modern Dairies Ltd	International Finance Corp (IFC) , World Bank's private sector investment arm	19.90
Moser Baer India Ltd	Woodgreen Investments Ltd, Warburg Pincus co.	13.10
Shriram EPC Ltd	Bessemer Venture Partners Trust	23.84
Spanco Telesystems and Solutions Ltd	Monet Ltd., s/o ChrysCapital, a PE	14.92
Varun Shipping Co Ltd	Caledonia Investments Plc, an investment trust	11.16

***Source*:** Based on the shareholding patterns as on September 30, 2010, available at the Bombay Stock Exchange website http://www.bseindia.com.

investment and that the "reason applies to domestic investment as well."[86] These are the cases that fall under Hymer's Type 1 FDI category. In fact, it might not be possible to distinguish domestic and foreign financial investors especially when the latter are promoted by locals after gaining considerable experience in similar businesses abroad. For instance, a perusal of senior management (including Indians) and other Indians working with General Atlantic, a leading global investment firm, reveals that most of these have commonality in terms of the business schools they attended and past employment with consultancy/ investment firms. (Annexure D) This is also true when operations in the host country are handled by locals with foreign investors exercising control but not

strategy.[87] Then there are Indian companies which float offshore companies and bring back the funds raised abroad as FDI. It is evident that analysis of FDI companies' operations based on the sole 10 per cent foreign equity criterion is likely to come out with erroneous results. Added to such financial investors, if companies in which Indians themselves hold shares and control enter as FDI investors, there will be very little justification for classifying such investment as FDI. As has been mentioned earlier, such cases appearing among the 2,748 inflows have been treated as round-tripping ones by us (Table 21). An analysis which treats such companies as FDI companies could obviously end up projecting a misleading picture.

Table 21: Companies which could be Classified as FDI Companies by the 10 per cent Criterion and where the Companies are Constituents of Some Indian Promoter Groups

Indian Company	Foreign Promoter	Share in Equity (%)
(1)	(2)	(3)
Sterlite Industries India Ltd	Twinstar Holdings Ltd	56.98
Madras Aluminium Co. Ltd	Twinstar Holdings Ltd.	80.00
Zee Entertainment Enterprises Ltd	Delgrada Ltd	17.20
Essar Shipping Ports & Logistics Ltd	Teletech Investments India Ltd	20.56
United Breweries Holdings Ltd	Watson Ltd	21.19
Essel Propack Ltd	Lazarus Investments Ltd	10.90
Rama Phosphates Ltd	NRI Investors Inc	31.86
Exide Industries Ltd	Chloride Eastern Ltd	48.87
Zensar Technologies Ltd.	Pedriano Investments Ltd	21.55
Punj Lloyd Ltd	Cawdor Enterprises Ltd	24.94
Patni Computer Systems Ltd	iSolutions Inc	14.25
Ispat Industries Ltd	Ispat Steel Holdings Ltd	17.00
HCL Technologies Ltd	HCL Holdings Pvt Ltd	18.26

Source: Based on the shareholding patterns as on September 30, 2010, available at the Bombay Stock Exchange website http://www.bseindia.com.

It is evident that one could place far more reliance on RBI's FCRC studies which followed stricter criteria than on those based on the broader FDI criterion. At one point of time in the past, the Research & Statistics Division of the then Department of Company Affairs used to bring out Factsheets on

Foreign Subsidiaries and Branches in India. Unfortunately, while there is far more emphasis on attracting FDI in India now, reliable and representative data sources on FDI company operations have not developed commensurately. In fact, one could affirm that there has been marked deterioration. Even the Research & Statistics division has stopped bringing out Factsheets on Foreign Branches and Foreign Subsidiaries, not to speak of those Indian non-government companies with a minimum of paid-up capital. The emphasis has been on relaxing policies and improving procedures with little effort to develop a monitoring mechanism.

3.4 Private Equity and Venture Capital

In view of the important place of PE/VC/HFs in the reported FDI inflows it would be in order to pay specific attention to their characteristics keeping in view the expectations from such investments in general and from FDI in particular. While there is no systematic reporting of PE/VC/HF investments by the government, some private agencies collect data from various sources and bring out reports periodically to give their own assessment of the situation. Observations based on such studies would always have classification and coverage problems and have to be interpreted with caution. Nevertheless, we shall present a few impressions emerging out of the available data and information.

It appears that globally private equity investments have been shifting to emerging markets. Though their share fluctuated, it increased from about 4 per cent in 2001 to the peak of 22.20 per cent in 2009. The reported amounts were $ 1.93 bn in 2001 and $ 7.20 bn in 2004. Thereafter the investments increased rapidly to $ 53.14 bn in 2007. In the subsequent two years, the amount fell to $ 22.10 bn in 2009. The share of BRICS within the emerging markets remained about half. Within BRICS, India's position improved *vis-a-vis* China till 2007 when it managed to overtake China, though it fell behind China in the subsequent two years.[88] The Working Group on Foreign Investment also acknowledged this when it said: "FDI inflows began in the early 1990s and have gathered momentum, particularly after India became important to global private equity funds."[89]

Though precise break-up between foreign and local PE/VC/HF investors is not available, it does appear that foreign funds dominate the PE/VC/HF scene in India. For instance, according to SEBI, at the end of December 2009, against the total investments of Rs. 26,827 crore by Foreign Venture Capital Investors (FVCIs) registered with it, investments by Indian Venture Capital

Funds (VCFs) was of the order of Rs. 15,232 crore.[90] A closer examination of the list of registered FVCIs, however, suggests that some of the FVCIs were indeed promoted by Indian financial institutions like the ICICI, IDFC, UTI and IL&FS.[91] (Table 22) In view of this, not all FVCIs can be expected to exhibit the characteristics of a foreign venture capital. Yet another aspect to the registered FVCIs, relevant in the overall context of this study is that out of the 144 FVCIs as many as 140 were based in Mauritius, including the ones related to Indian institutions. Expectedly most of these (once again including those promoted by the Indian institutions) are located at just a few addresses: two in Cyprus and the remaining two in Singapore. Another dimension to the domestic VCFs is that some of these belong to Indian large business group and financial institutions. Composition of top management and investment advisers of some of the registered VCs suggests that it is difficult to classify them either as Indian or foreign.[92]

From probably a more systematic study of the sector (foreign and domestic funds together) in India, we find that manufacturing was not the favoured area for PE/VC investment as telecom and media, engineering and construction and financial services claimed increasingly larger shares.[93] (Annexure E) Companies which are in their late stage of development or which are already listed on the stock exchanges were the most preferred recipients. In this, the study also found that while majority of early stage investments are contributed by domestic investors, a large share of PIPE[94] and buyout investments are funded by foreign investors, suggesting the tendency of foreign investors to invest in established businesses.[95] Further, it was noticed that as many as 75 per cent growth stage investments exited in less than two years underlying the short-term nature of PE/VC investments in India. PE/VC investments in India were indeed put under the category of 'quick flips'.[96] A recent study noted that an overwhelming proportion of PE/VC fund managers have experience in financial management thereby further underlining their financial investment nature in India.[97] It is evident that India's experience with PE/VC investments does not support the traditional view for such investments and it is highly unlikely that India would be able to derive the benefits associated with such investments unless there is a drastic change in their approach. It is, therefore, further justified to term them as portfolio investments instead of treating them as FDI merely because the respective investors happen to hold the minimum qualifying equity level of 10 per cent. Further, given the manner in which private equity funds are floated and run, to which venture capital belongs to, one wonders in what way 'foreign' venture capital differs from domestic private venture capital and why should the former be preferred to the latter.

Table 22: Illustrative Cases of Overlapping of Domestic and Foreign Venture Capital Investors Registered with SEBI

Foreign Venture Capital Investor(s)	Corresponding Domestic Venture Capital Fund(s)
(1)	(2)
2i Capital PCC	Indian Enterprise Fund
AIF III Sub Pvt. Ltd (sponsored by UTI)	UTI - India Technology Venture unit scheme
Aureos Offshore India Opportunities Fund, LLC Aureos South Asia Fund LLC	Aureos India Fund
Avigo venture Investments Ltd	Avigo India Private Equity Trust
BTS India Private Equity Fund Ltd	BTS India Private Equity Fund
Footprint Ventures (Mauritius), Ltd	Footprint Venture India Fund
IDFC Private Equity (Mauritius) Fund II IDFC Private Equity (Mauritius) Fund III IDFC Project Equity Company II (Mauritius) Ltd IDFC Project Equity Company IV (Mauritius) Ltd	IDFC - India Infrastructure Fund - 3 IDFC Infrastructure Fund IDFC Infrastructure Fund - 2
Dynamic India Fund 1 Dynamic India Fund III Dynamic India Fund V Dynamic India Fund IV (ICICI Real Estate Fund)	India Advantage Fund 1 India Advantage Fund -III India Advantage Fund IV India Advantage Fund V India Advantage Fund VIII ICICI Econet Fund ICICI Emerging Sector Trust
India Leverage Fund LLC	IL&FS ORIX Trust IL&FS Private Equity Trust
JM Financial - Old Lane India Corporate Opportunities II Ltd (previously known as JM Financial India II Ltd)	JM Financial India Fund JM Financial Property Fund
KSK Emerging India Energy Pvt Ltd - I	Small is Beautiful
SEAF India International Growth Fund	SEAF India Investment Trust
Ventureast Biotech Fund	Ventureeast Telnet India Fund
Zephyr - Peacock India I	Zephyr Peacock India II Trust

Source: Based on the information made available by Securities and Exchange Board of India (SEBI) on its website www.sebi.gov.in

In any case, it is extremely relevant to note that after 2007, Round-tripping related PE/VC/HF investments and Round-tripping as such gained in importance in the total inflows while the other PE/VC/HF investments declined relatively in line with international experience. (Table 23 and Chart 9). It can be

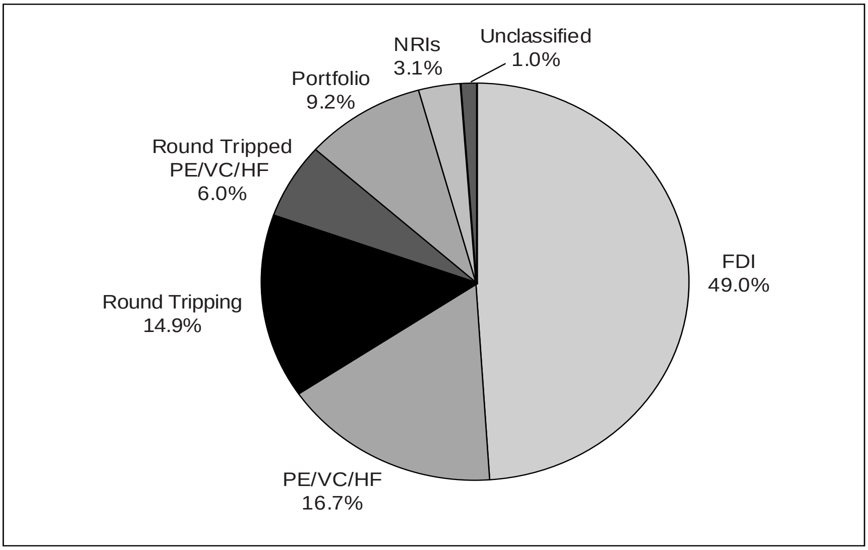
seen further that it is the portfolio investments comprising of PE/VC/HF, NRIs and Other Portfolio types which declined sharply in 2009 while there was only a slight dip in what can be termed as "development-oriented" FDI inflows. In contrast, total Round-tripped investments registered a marginal increase. (Table 24 and Chart 10). Obviously, instead of looking at the aggregates, an analysis of the individual inflows could throw better light on the factors/investors that are responsible for the slowdown during 2010-11.

Table 23: Growing Importance of Round-tripping Inflows

Year	Share in Total of 2,748 Equity Inflows (per cent)			
	PE/VC/HF Only	Round-tripped PE/VC/HF	Round-tripping Only	Total Round-tripping Cols. (3) + (4)
(1)	(2)	(3)	(4)	(5)
2004 (Sep-Dec.)	29.83	0.00	1.68	1.68
2005	15.96	1.92	1.38	3.30
2006	20.94	2.81	1.28	4.10
2007	34.87	2.88	9.19	12.07
2008	23.20	3.72	11.48	15.19
2009	16.67	6.09	14.94	21.03
Total	22.90	4.02	10.30	14.32

Source: See Table 9.

Chart 9: Share of Different Categories of Foreign Investors in Top Equity Inflows during 2009



Source: See Table 24.

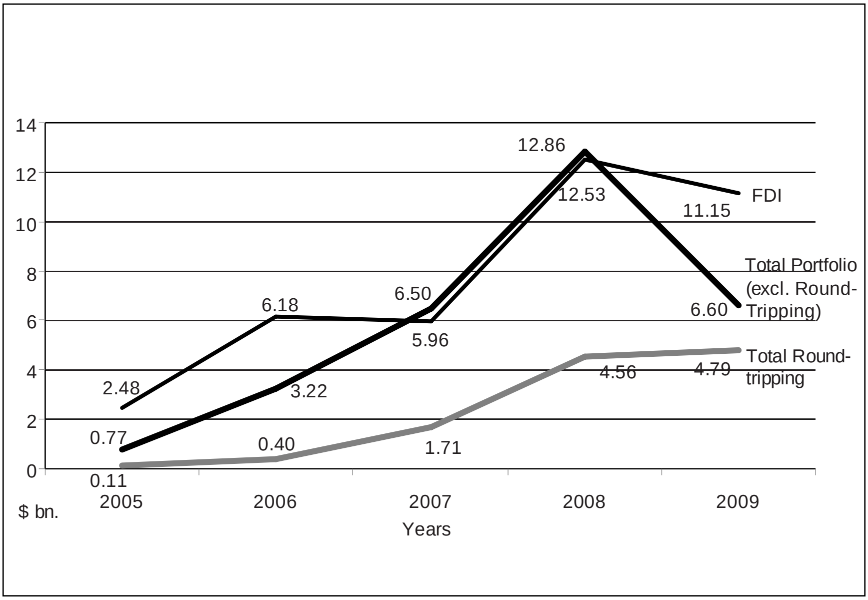
Table 24: Year-wise Equity Inflows According to the Type of Investor

in $ mn

	Type of Investor	2005	2006	2007	2008	2009
	(1)	(2)	(3)	(4)	(5)	(6)
1	FDI	2,482	6,184	5,962	12,526	11,154
2	PE/VC/HF	540	2,056	4,947	6,959	3,796
3	Portfolio	209	625	785	3,738	2,093
4	NRI	17	536	770	2,167	706
	Total Portfolio (excl. Round-Tripping) (2+3+4)	*766*	*3,217*	*6,502*	*12,864*	*6,595*
5	Round-tripping	47	126	1,304	3,443	3,400
6	Round-tripped PE/VC/HF	65	276	409	1,115	1,387
	Total Round-Tripping (5+6)	*112*	*402*	*1,713*	*4,558*	*4,787*
7	Unclassified	24	17	8	50	228
	Grand Total	3,384	9,820	14,186	29,996	22,764

Source: See Table 9.

Chart 10: Differing Behaviour of FDI, Portfolio and Round-tripping Investments in 2009



Source: See Table 24.

4. Interpreting the Results

Policies of economic liberalization that India has adopted since the early 1990s, included, as an integral part, a greater role for foreign capital in the country's economy. In so doing, a two-pronged strategy was adopted: one to attract FDI which is seen, in addition to net capital accruals, as a bundle of assets like technology, skills, management techniques and access to foreign markets; and two, to encourage portfolio capital flows which help develop capital markets and ease the financing constraints of Indian enterprises. The FDI policy was liberalized gradually: foreign investors were allowed to operate with a far greater degree of freedom and only in small number of industries did they face restrictions.

After a slow and gradual rise till the middle of 2000s, inflows increased rapidly thereafter. From an average of just $ 1.72 bn. during 1991-92 to 1999-00, and the slightly higher $ 2.85 bn. during 2000-01 to 2004-05, the average annual equity inflows surged to $ 19.78 bn. during 2005-06 to 2009-10. Viewed in the context of considerable discussion and concern regarding FDI inflows not matching India's potential and being far lower than the initial expectations, the surge since the mid-2000s did succeed in projecting the picture of growing confidence in India of international investors. Recent data, however, suggests that inflows during 2010-11 were substantially lower than that in 2009-10.

This study undertook a detailed analysis of the FDI inflows during the period September 2004 and December 2009, the period for which data for actual inflows were available at the time of its initiation. In the process of analysing the characteristics of the inflows, the study highlighted the ambiguities in the measurement of FDI, especially the choice of the threshold level of 10 per cent for determining control and lasting interest of the foreign investor. We also questioned this approach of measuring FDI since by so doing, the boundaries between foreign direct and portfolio investments have become blurred. It also raised the possibility of the reported inflows under the head Acquisition of Shares underestimating the extent of takeover of Indian businesses by foreign companies as not all the inflows into taken over existing companies and new companies formed by transferring existing business are uniformly captured under this head.

Analysis of the available data on FDI inflows, included in the earlier section, had shown that the inflows were taking place in a number of forms, which would make little or no impact on the country's development. Thus, re-invested earnings, which turned out to be a major component of FDI inflows since India adopted the international reporting practice, does not contribute to infusion of fresh capital in the country. Another important

component, the inflows through the acquisition route, also does not add to the existing capacities in goods and services production. Furthermore, increasing proportion of inflows being routed through tax shelters implies considerable revenue loss to the exchequer.

Official data suggest that there has been a perceptible shift in the sectoral composition of inflows with the growing dominance of non-manufacturing sectors. Patterns of global FDI flows seen in the past suggest that India's experience with FDI inflows is not unique. For instance, according to UNCTAD *World Investment Reports*, the share of the manufacturing sector in global FDI flows declined from 34.2 per cent to 24.0 per cent between 1989-1991 and 2005-2007.[98] The corresponding decline for developing economies was from 46.5 per cent to 31.0 per cent. One the other hand, the share of the services sectors increased from 50.5 per cent to 59 per cent for the world as a whole, while for developing countries the increase was from 30.8 per cent to 56.7 per cent. Within services, the importance of financial sector has increased in the latter period: from 17.7 per cent to 21.4 per cent. In case of developing countries, the increase was far sharper: from 6.3 per cent to 19.3 per cent. And finally, it is also acknowledged that private equity plays a major role in global FDI flows, especially in those involving M&As.

The present study analysed the features of the officially reported largest 2,748 cases of FDI Equity inflows, each individually accounting for at least $ 5 mn during September 2004 to December 2009. These cases are fairly representative in value terms of the total equity inflows through the FIPB/SIA, Acquisition and Automatic routes, as they accounted for about 88 per cent of the total for the period. A distinctive feature of this exercise, which to the best of our knowledge has not been attempted so far, is the classification of the foreign investors with a view to assess the flows from the point of their meeting the criteria and expectations from FDI. Given the gaps in information, the exercise has been quite a challenging one. Notwithstanding these limitations, we do hope that the exercise would help take the understanding of FDI further not only in India but in the international context as well. Some of the key findings are as follows.

An attempt was made to identify the foreign investors who have the potential to contribute to India's development process by (i) establishing a long-term interest in the country and (ii) bringing in not only capital but also the associated benefits on their own strength. These investors, in our view, constitute the "development-oriented" FDI. Our analysis revealed that only a little less than half of the inflows could meet the twin criteria referred to above. Excluded from the category of "development-oriented" are private equity investors and other portfolio investors as well as inflows under control of Indians/Indian companies (termed as Round-tripping investment).[99]

"Development-oriented" FDI was the most important component of total inflows in the telecommunications sector. Its share was high also in the manufacturing sector (about 62 per cent of the total). On the other hand, the share of "development-oriented" FDI was the least in case of the construction and real estate sector and other infrastructure, implying thereby that there was not much by way of proprietary knowledge that the foreign investor had brought in into these sectors. "Development-oriented" FDI that could add to the existing manufacturing facilities, the main focus of the Statement on Industrial Policy of July 1991, formed only a small proportion of the total reported inflows. In general, non-acquisition type "development-oriented" FDI accounted for 36 per cent of the total inflows of $81 bn. covered by the 2,748 cases and that going into manufacturing sector formed a mere 10 per cent of the total. (See Diagram).

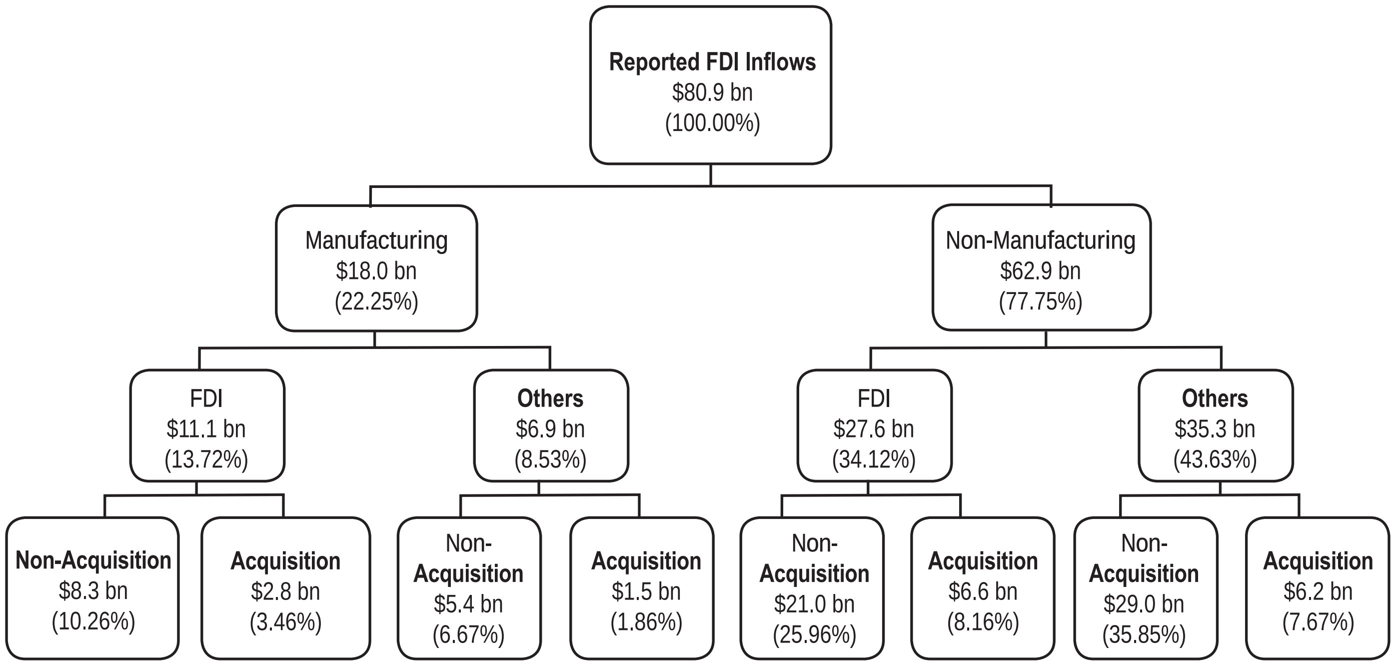
Only a small proportion of the total inflows are subjected to specific government approvals. Interestingly, compared to the other investors, specific approval from the government (FIPB/SIA) was sought to the maximum extent by what we termed as "development-oriented" FDI. Nearly all of NRIs' investment is through the Automatic Route. More importantly, more than 90 per cent of the inflows under the Round-tripping and PE/VC/HF categories of investors were not subjected to case-by-case approvals. In other words, they entered just like FII investments which do not require specific approval once they are registered with the Indian regulatory authorities.

Our analysis shows that most of the PE/VC/HF and Round-tripping variety of inflows entered via tax havens. This tendency was displayed more by PE/VC/HFs promoted by Indians. Most of the investments in telecom and IT&ITES, and in construction and real estate sector passed though such countries. Interestingly, about 90 per cent of such investments in the construction and real estate sector were routed through the tax havens and have the benefit of automatic entry. Our contention is that PE/VC/HF investments must be viewed differently since these investments seek higher and quicker gains and are, therefore, prone to speculative expectations.[100] There is, therefore, no guarantee that there would be net addition to domestic investible resources even in the medium term. Further, the tax haven route that they have exploited for entry into India ensures that the exchequer would not gain much from the profits they earn.

4.1 Measurement and Classification (Direct or Portfolio)

An inescapable conclusion, notwithstanding the status accorded to such investments by the international agencies and adopted across nations, is that a good part of the FDI flowing into India is more akin to portfolio investment. What seems to be happening in practice is that *all* equity investments which are not coming through the foreign institutional investor (FII) route are being

Diagram: Composition of the Reported Top 2,748 Equity Inflows



Figures in parentheses are percentages calculated with respect to total reported inflows.

treated as FDI *irrespective* of the proportion of shares held abroad and the extent of influence of the foreign investor.[101] This becomes amply clear from the Draft Press Note on FDI Regulatory Framework. Interestingly, even important official advisory bodies appear to be unaware of how the FDI data were being compiled. Available estimates of FDI may help India project itself as an attractive destination, but these inflows do not ensure that the expected benefits are no better than ADRs/GDRs which are treated as portfolio investment and external commercial borrowings. Indeed, given the possibility that institutional investors who invest in companies listed on the Indian stock exchanges as FIIs, subscribe to ADR/GDRs as also invest in India-focussed companies on the London Stock Exchange, the inflows on account of the latter could also be seen as another form of foreign portfolio capital.[102]

It is evident that at the global level the 10 per cent criterion is being used as a thumb rule and even investments which are unlikely to exhibit the characteristics of typical FDI are being categorised as such for BOP measurement purposes. That the 10 per cent criteria is adopted mainly because of the stated objective of ensuring comparability across nations, and that a suggestion to raise the limit to 20 per cent in accordance with the International Accounting Standards was summarily rejected makes the limit even more open to question. As a result, various forms of financial investments, which one finds difficult to unquestionably treat as FDI, are being considered as such. There is also the question of their potential impact on the host countries about which not much is known. These are not miniscule in size as they account for a sizeable portion of global FDI flows. Notwithstanding the fact that such investments are accompanied by control/influence as well, their investments cannot be distinguished from typical financial investors. Unlike typical FDI, private equity investments come with a pre-conceived idea of exiting the venture after certain duration.[103] They do not own any proprietary technology and hence the investee enterprises may only be directed to the appropriate sources. Private equity and other portfolio investments do not fall under the standard motives of efficiency seeking, market seeking and resource/strategic asset seeking FDI. They may, if necessary, be categorised as pure return seeking FDI. Given the manner in which the sector proliferated, those who promote and run the PE firms are more like global consultants who work for a fee. These include persons of Indian origin/nationality many of whom cannot be distinguished from foreigners in terms of education, training and experience. Except for the fact that capital flows from another country, one does not find anything related to nationality about them.

The data we have analysed in an earlier section show that the way domestic investors floated PE firms abroad (and possibly raised money abroad

genuinely),[104] some of the registered domestic venture capital companies having strong foreign affiliation and many large Indian business groups and banks entering private equity business, the distinction between 'domestic' and 'foreign' has got even further blurred. In the choice of tax havens too, both have something in common. In the ultimate analysis, the FDI route has also become a conduit for domestic entrepreneurs to avoid taxes and worse still in some cases going by the multi-layering adopted by them raise serious doubts about the origin of the funds.[105] The differences in the behaviour of "development-oriented" FDI, all Portfolio investors (excluding Round-tripping) and Round-tripping came out sharply in 2009. While "development-oriented" FDI declined marginally, portfolio investments fell sharply. On the other hand, Round-tripping investments increased slightly.

In 2003, while deciding on the *Azadi Bachao Andolan* petition, the Supreme Court justified the tax advantage offered to foreign investors coming through the tax havens like Mauritius in the following manner:

> There are many principles in fiscal economy *which, though at first blush might appear to be evil, are tolerated in a developing economy*, in the interest of long-term development. Deficit financing, for example, is one; treaty shopping, in our view, is another. Despite the sound and fury of the respondents over the so-called "abuse" of "treaty shopping", perhaps, it may have been intended at the time when the Indo-Mauritius DTAC was entered into. *Whether it should continue, and, if so, for how long, is a matter which is best left to the discretion of the executive as it is dependent upon several economic and political considerations.* This court cannot judge the legality of treaty shopping merely because one section of thought considers it improper.[106] (emphasis added)

In early 2010, the Authority for Advance Rulings (Income Tax) New Delhi, while upholding the foreign investor's claim of non-liability of Tax on the sale of shares held by E'Trade Mauritius Ltd in an Indian company, said:

> Though it looks odd that the Indian tax authorities are not in a position to levy the capital gains tax on the transfer of shares in an Indian company, this is an inevitable effect of the peculiar provision in India-Mauritius DTAA, the Circular issued by CBDT and the law laid down by Supreme Court in Azadi Bachao case. *Whether the policy considerations underlying the crucial Treaty provisions and the spirit of the Circular issued by the CBDT would still be relevant and expedient in the present day fiscal scenario is a debatable point and it is not for us to express any view in this behalf.* (emphasis added).[107]

Earlier, the Comptroller and Auditor General of India in its report on direct taxes *System Appraisals* for the year 2003-04 emphasised that:

> ... a holistic study of DTAAs be conducted to ascertain the benefits accruing to the nation, especially as these are not placed before Parliament. A well-designed and periodical cost benefit analysis would also need to be put in place.
>
> Shortcomings in DTAAs, especially those relating to definition and operation of permanent establishment, limitation of treaty benefits and disallowing treaty shopping needed to be removed so as to curtail misplaced incentives and ensure that the benefits of DTAAs are availed by bonafide assessees.[108]

In view of the evidence proffered above and press reports indicating the deployment of tax havens by Indians themselves, there is a need to rethink on the issue, especially since the economic conditions to which the Supreme Court alluded to do not exist any longer and even the world at large has recognised the need to restrict the abuse of tax havens.[109] Should this facility, which works as a tax incentive, be extended to all sectors and all types of investors? Instead, can India think of offering tax incentives directly to both domestic and foreign investors in selected sectors based on certain performance criteria?

Portfolio investment which does not come through the stock market may not be as volatile as that which comes through it. The recent crisis has, however, shown that the former could be less reliable as the flows, even if they cannot be withdrawn, can dwindle and affect the economies which rely on them to meet the current account gap. On the other hand, there is nothing which suggests that such investments by themselves enhance the capabilities of investee companies to contribute to bridge the current account gap. Taking advantage of the liberal FDI definition, which does not distinguish between the nature of the investor, portfolio investors may adopt the FDI route more in the event of capital controls being imposed on portfolio investments.

As has been mentioned earlier, the RBI is now concerned about the fall in FDI inflows during the current financial year (2010-11) in the context of higher level of current account deficit and dominance of volatile portfolio capital flows. Besides the environmentally sensitive policies pursued, it identified the sectors responsible for the slow down as "construction, real estate, business and financial services".[110] It is evident that except for IT and ITES, these services would not be directly contributing to foreign exchange earnings. We have seen in the foregoing that inflows into the Construction and Real Estate sector are dominated by PE/VC/HF investors and Round-tripping investments which

cannot be equated with FDI. Not long ago it was reported that "RBI, which has been consistently cautious over the FDI flow into the realty sector, has warned that such massive flows could lead to speculation and over-heating of the real estate sector".[111] RBI also seems to have wanted to "take property market out of the sectors which allows FDI through the automatic route. It wants inflows routes such as participatory notes and private equity contained".[112] Indeed, FDI into the sector is subject to three-year lock-in. The present change in attitude seems to have been driven by the need to meet current account deficits and the belief that all FDI inflows are longer-term commitments. The primary role of FDI has thus been reduced to a foreign exchange management tool and probably reflects a change in the global approach towards FDI. The shift in the perception of FDI where the attributes other than capital are pushed to the background can be seen from an IMF publication which when describing that FDI is favoured over other capital flows by emerging markets, explained that:

> FDI is not debt creating, is less volatile than portfolio flows, and relatively resistant during financial crises (…). FDI has *also been associated* with positive spillovers through technology transfer and training to local industry (…), and *may lead to enhanced export performance and growth* (…). (emphasis added) [113]

Thus, even the IMF is not sure of the developmental impact of FDI. FDI's contribution to enhancing host country's export potential and thus contributing to its ability to *earn* foreign exchange is also not guaranteed. No wonder, India is now seeing FDI as a means of bridging the current account gap with 'stable' inflows without reference to its quality.

Apart from the policies related to environment, RBI's suggestion to address other problem areas like procedural delays, land acquisition issues and availability of quality infrastructure is more generic in nature and by itself may not ensure directing capital flows to India. There is every possibility that the fall in inflows would be used to push further opening up of the sectors which have hitherto been partially open to FDI. The need to maintain a steady stream of foreign capital is shrinking the policy space even when certain policies are not working to India's advantage.

4.2 A Case for Selective Approach towards FDI

Before seeking to benefit from FDI it is essential to clearly identify the same. Thus, going back to the definitional aspect of FDI, one finds that the essential criterion followed for identifying an FDI enterprise is control/influence. While unambiguous control is generally seen in owning majority share in equity, significant influence is expected to exist when there is an equity share between

10 per cent and 50 per cent. It is also believed that one can have control with less than 10 per cent share and not have control even with shares higher than 10 per cent. The primary criteria itself is a matter of debate and FDI is open to subjective interpretation and judgment. Other items like reinvested earnings, other capital, etc. only follow from this first level identification. The whole edifice is thus built on what is well acknowledged as an 'arbitrary' cut-off point of 10 per cent, vaguely defined 'lasting interest' and 'significant influence.[114] Indeed, it is difficult to understand the full meaning of IMF BPM6 when it says:

> Because there is control or a significant degree of influence, direct investment tends to have different motivations and to behave in different ways from other forms of investment. As well as equity (which is associated with voting power), the direct investor may also *supply other types of finance, as well as knowhow*. *Direct investment tends to involve a lasting relationship, although it may be a short-term relationship in some cases.* Another feature of direct investment is that *decisions by enterprises may be made for the group as a whole.* (emphasis added)[115]

It implies that direct investment is much more than a share in equity and involves supply of other types of finance and knowhow *and* decisions are made for the group as a whole. This is more akin to investments by TNCs. However, the difficult part in this is about the 'lasting relationship' of a 'short-term' nature. Obviously, the lower limit of 10 per cent which is neutral to the nature of the foreign investor would bring far more cross-border investments, including cases that are typically portfolio investments, into the ambit of FDI than a higher cut-off point would do. And indeed, this has been the case as India's experience described in the foregoing had demonstrated. Foreign control by itself may be important when it comes to ascertaining liabilities of various sorts or in strategic sectors. This is irrespective of whether a particular company is categorised as an FDI one or not. The two should be treated separately.

This is as far as the need to clearly identify FDI within the global and individual host country's capital flows before one can plan to use it to ones advantage. On the other hand, there is considerable body of literature which does not offer unqualified endorsement of positive impact of FDI on host countries and which implies a calibrated approach towards it. The situation is well summed up in the following:

> We know that there is a lot we still do not know about FDI and MNCs, but not exactly what or how much. ... Few undisputed insights exist on which policy makers can definitely rely. ''The economic effects of FDI do not allow for easy generalizations.

> Empirical studies on the growth impact of FDI have come up with conflicting results.''[116]

and,

> After resolving many statistical problems plaguing past macroeconomic studies and confirming our results using two new databases on international capital flows, we find that FDI inflows do not exert an independent influence on economic growth. Thus, while sound economic policies may spur both growth and FDI, the results are inconsistent with the view that FDI exerts a positive impact on growth that is independent of other growth determinants.[117]

Following such evidence it is logical for adopting a selective approach towards FDI. For instance, it is said:

> The experience of many recent development successes supports our call for a more interventionist approach towards TNCs – which policymakers and academics from various parts of the world are embracing. Countries such as Korea, Taiwan, Singapore and China were able to incorporate TNCs within their national projects in their own terms and under their own conditions. Even Singapore, which actively promoted FDI inflows, protected strategic sectors from foreign competition and implemented different measures to promote domestic upgrading. While international agreements may prohibit some of the measures that Korea, Taiwan and Singapore implemented, there is still some policy space available for a more restrictive approach to TNCs. *To summarise, countries which manage their FDI are likely to benefit more than those which are managed by their FDI*. (emphasis added)[118]

similarly,

> ... there are good reasons to believe that an industrialized strategy based on laissez faire attitude towards TNCs may not be as successful in the long run as a more selective, strategic approach, as seen in the examples of countries like Korea and Taiwan.[119]

At one time the expectations from FDI were rather clear; and even now the most widely accepted view is that it is much more than capital transfer. And probably that was the reason why developing countries could be convinced of the need to attract FDI. (See Box 1)

Box 1: FDI comprises a package of resources …

Extracts from UNCTAD, *World Investment Report: Foreign Direct Investment and the Challenge of Development, 1999*.

Most developing countries today consider FDI an important channel for obtaining access to resources for development. However, the economic effects of FDI are almost impossible to measure with precision. Each TNC represents a complex package of firm-level attributes that are dispersed in varying quantities and quality from one host country to another. These attributes are difficult to separate and quantify. Where their presence has widespread effects, measurement is even more difficult. ... the assessment of the development effects of FDI has to resort either to an econometric analysis of the relationships between inward FDI and various measures of economic performance, the results of which are often inconclusive, or to a qualitative analysis of particular aspects of the contribution of TNCs to development, without any attempt at measuring costs and benefits quantitatively.

FDI comprises a bundle of assets, some proprietary to the investor. The proprietary assets, the "ownership advantages" of TNCs, can be obtained only from the firms that create them. They can be copied or reproduced by others, but the cost of doing that can be very high, particularly in developing countries and where advanced technologies are involved. Non-proprietary assets—finance, many capital goods, intermediate inputs and the like—can usually be obtained from the market also.

The most prized proprietary asset is probably technology. Others are brand names, specialized skills, and the ability to organize and integrate production across countries, to establish marketing networks, or to have privileged access to the market for non-proprietary assets (e.g. funds, equipment). Taken together, these advantages mean that TNCs can contribute significantly to economic development in host countries—if the host country can induce them to transfer their advantages in appropriate forms and has the capacity to make good use of them. (p. 25)

The development impact of FDI, however, also depends on the *dynamics* of the transfer of technology and skills by TNCs: how much upgrading of local capabilities takes place over time, how far local linkages deepen, and how closely affiliates integrate themselves in the local learning system. TNCs may simply exploit the existing advantages of a host economy and move on as those advantages erode. Static advantages may not automatically transmute into dynamic advantages. This possibility looms particularly large where a host economy's main advantage is low-cost unskilled labour, and the main TNC export activity is low-technology assembly.

The extent to which TNCs dynamically upgrade their technology and skills transfer and raise local capabilities and linkages depends on the interaction of the trade and competition policy regime, government policies on the operations of foreign affiliates, the corporate strategies and resources of TNCs, and the state of development and responsiveness of local factor markets, firms and institutions. (p. 30)

Even today in spite of a variety of foreign investors coming into play and with increasing dominance of financial investors about whose impact on host countries one is not sure of, international bodies continue to present the prospect that:

> ...unlike portfolio equity and bond investments, FDI decisions are made with long-term horizons in view. They express the intention to build productive manufacturing facilities, exploit natural resources, or diversify export bases. Thus, FDI flows are less likely to be liquidated *or reversed* in times of crisis.[120] (emphasis added)

Notwithstanding the clarity in objectives and expectations from FDI the broader definition of FDI that has prevailed blurred the boundaries between portfolio and direct investments. A situation has been reached when FDI is referred to for its developmental impact even while the widely available measurement is that of BOP based FDI resulting in a wide gap between what is meant and what is measured as FDI.[121] Instead of representing capital flow with clear developmental connotation, it has turned into generic capital flow. Recent developments are consistent with these observations. For instance, substantial decrease in M&As (a good part of which is financed by private equity) and a sharp fall in 'FDI by private equity funds' rather than a slowdown in greenfield operations explain most of the drop in FDI in 2008 and 2009.[122] It is apparent that the characteristics of portfolio investments got reflected in the behaviour of globally measured FDI. Indeed a critic of UNCTAD had said:

> For, despite the eclectic nature of its presentation (where it sometimes criticizes speculative capital), UNCTAD/WIRs leave the overall impression that all the figures that it provides for FDI are indeed "genuine" FDI which plays a "significant" role in the development of Third World countries. This is, to say the least, highly misleading and improper.[123]

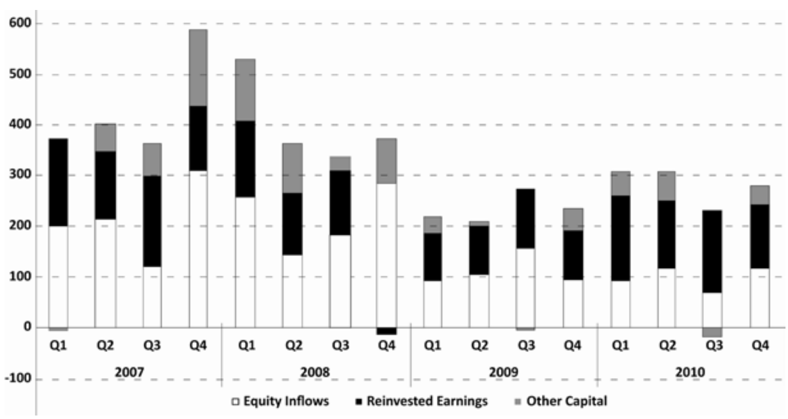
While India's FDI data did reveal some major deviations and specific features one does not know the extent of such anomalies in respect of FDI data of other countries. It is also necessary to underline here that a number of companies which are reported as recipients of FDI do not appear among the foreign affiliates in India reported on the ITC-UNCTAD database www.investmentmap.org. The information for the database is provided by Dun & Bradstreet—world's leading corporate information provider.[124] One is not sure about other countries.

The aggregate FDI data reported by UNCTAD needs to be understood with many a qualification. For instance, UNCTAD in its *Global and Regional FDI Trends in 2010* reported that global capital flows *stagnated during 2010* compared to

2009. The details, however, explain that "(I)mproved economic performance in many parts of the world and increased profits of foreign affiliates, especially in developing countries, lifted reinvested earnings to nearly double their 2009 level".[125] A look at the accompanying graph clearly suggests that actual cross-border flows might have *fallen considerably during 2010* thus giving scope to a completely different interpretation of the global situation. Indeed, the April 2011 release by the UNCTAD states, based on data of FDI outflows of 44 (mainly developed) countries, that both reinvested earnings and other capital flows increased by 45 per cent in 2010, while equity investments *dropped* by 11 per cent. (Box 2) The share of reinvested earnings was indeed in excess of 50 per cent of the total.[126] If they are not aware of these details, countries like India who have experienced a fall in the inflows might get the impression that they had fared badly in a situation of stagnant global FDI flows.

Box 2: Quarterly FDI Outflows by Components for 44 Selected Economies (2007 – 2010)

($ bn.)



Source: UNCTAD, *Global Investment Trends Monitor*, No. 6, April 27, 2011.

The difference between FPI and FDI having been minimised through the propagation of a liberal BOP-based definition, an environment of competition among countries for attracting FDI has emerged fuelled by indicators like FDI Confidence Index, Inward FDI Attractiveness index, Inward FDI Performance Index, etc. Developing countries vie among themselves for larger volumes of FDI. It was indeed argued against such comparisons:

> India has the potential for attracting increased volumes of FDI. She can do so with a set of policies which are in the interests of not only foreign investors but also domestic investors. *It is though a bit farfetched to argue that FDI is a panacea for the development problem and India should throw all doors wide open to FDI. It would also be a folly to woo FDI if only because China attracts relatively high volumes of FDI.* [127] (emphasis added)

FDI policies need not have to be unidirectional. Just as they are liberalized, they could also be tightened if the situation so warrants.

> …it would be foolish to have either uniformly restrictive or uniformly liberal policies towards TNCs across different industries. This also means that the same industry may, and indeed should, become more or less open to FDI over time, depending on the changes in various internal and external conditions that affect it.[128]

After almost twenty years of trying to attract FDI probably the time has come to review India's FDI policy, not from the view point of maximizing the inflows but from the perspective of bridging the gaps and gaining from it.

4.3 Need for a Relevant Data System

While it may have become necessary to follow the international criteria for balance of payment purposes, a detailed break-up of the foreign capital inflows is unavoidable for a proper assessment of their developmental impact, the *raison d'etre* for FDI. Also required is a reliable data system which enables analysis of operations of a representative set of Indian companies, including FDI companies. Unfortunately, by switching over to the new definition of 'FDI companies' and abandoning what was probably the more appropriate category of FCRCs by the RBI, the representative character of the studies on foreign companies in India has become even more debatable. The control aspect underlying the definition of FCRCs more closely reflected provisions of the Companies Act. In fact, thanks to the poor information base of the Indian corporate sector itself, today the role and place of FDI in the economy is not known with any reasonable degree of accuracy. Consequently, studies are often based upon small sets of foreign companies identified from databases which have lost much of their relevance in this respect notwithstanding the fact that they do try to cover some unlisted companies as well.[129] With the importance of financial investors and Round-tripping investments in India's FDI inflows, there is a need to classify the investments according to the nature of foreign investors. Even OECD suggested that when the Round-tripping phenomenon becomes significant these should be indicated as separate supplementary breakdowns.[130]

Both at the global level and at the national level in India considerable time and other resources are being invested to promote FDI. To assess its contribution the need for a proper information base on the activities of FDI companies is well accepted. It is worth referring to UNCTAD when it said:

> FDI data alone are not enough to assess the importance and impact of FDI in host economies. They should be complemented with statistical information on the activities of TNCs and their foreign affiliates (e.g. sales, employment, trade, research and development (R&D)).[131]

It is also relevant to refer to Lipsey when he said:

> One would need an unusual type of FDI data to explain the role of such an investment and such an affiliate on the host economy, but the value of the investment stock or the corresponding flows, and the value of assets, sales, and value added are uninformative on the subject. Only host country data collection on establishment and firm bases, including real inputs such as labor and physical capital, and R&D, and financial flows such as tax payments, can begin to reveal host country impacts.[132]

India and probably many other countries are nowhere near having such a data system. Important components of the reported FDI inflows like 'reinvested' earnings and 'other capital' are simple estimates the veracity of which one cannot vouch for. It is time the Indian policymakers start making a clear distinction between different types of foreign investors which could help them in their own assessment of the situation on the one hand and enable assessment of benefits/costs by others, on the other.[133] In the absence of such an analysis, success of the FDI policy would only be measured in terms of attracting larger and larger amount of inflows to achieve which, beyond a point, one has no option but to open up more and more, accelerate privatization and encourage takeover of Indian companies. And there is a limit to it. The NMCC was indeed highly critical of India's FDI policy as it did not place due emphasis on technology transfer which is "considered to be one of the most important benefits of permitting FDI into a country" as the emphasis was on "the quantum of FDI received rather than on the quality of FDI". The NMCC underlined the need to "have a relook at our FDI policy in terms of the technological benefits the country needs to derive".[134]

There are multiple official agencies like the RBI, Ministry of Commerce and Industry, Ministry of Finance, Foreign Investment Implementation Authority (FIIA), FIPB, SEBI, Central Statistical Organisation (CSO), NMCC, Competition

Commission, Public-Private Partnerships with industry bodies and finally the Ministry of Corporate Affairs itself in dealing with foreign entities. What is required is an open mind and commonality in approach to unravel the FDI phenomenon and to maximise the benefits from it.

On its part, the UNCTAD, with its mandate to promote "the development-friendly integration of developing countries into the world economy", appears to be not only the appropriate organisation but also the one having the responsibility to take lead to help these countries in clearing the haze and take effective steps to benefit from FDI.

Endnotes and References

1 This seems to have been the mood when the UNCTAD was convened in 1964. The recommendations adopted at the conclusion of the UNCTAD I state: "[F]oreign private investment, based upon respect for the sovereignty of the host country, should co-operate with local initiative and capital, rely as far as possible on existing resources in developing countries, and should work within the framework and objectives of the development plans with a view to supplying domestic markets and, in particular, expanding exports", quoted by Torbjorn Fredriksson, "Forty years of UNCTAD research on FDI", *Transnational Corporations*, Volume 12, Number 3, December 2003, p. 3. See also Mira Wilkins, "Two Literatures, Two Story-lines: Is a General Paradigm of Foreign Portfolio and Foreign Direct Investment Feasible?", *Translational Corporations*, Vol. 8, No.1, April 1999, pp.53-116.

2 See for example, Raymond Vernon, *Sovereignty at Bay: The Multinational Spread of U.S. Enterprises*, Basic Books, New York, 1971.

3 Torbjorn Fredriksson, *supra* note 1.

4 Yingqi Wei and V. N. Balasubramanyam, *Foreign Direct Investment: Six Country Case Studies*, Edward Elgar Publishing, 2004.

5 For a description of this and the role played by the UN, especially UNCTAD, in this process see: s*upra* note 1, pp. 1-39. See also Marica Carcokovic and Ross Levine, "Does Foreign Direct Investment Accelerate Economic Growth?" in Theodore H. Moran, Edward M. Graham and Magnus Blomstrom (eds.), *Does Foreign Direct Investment Promote Development?*, Centre for Global Development, Washington, 2005, for a review of the literature on the impact of FDI on economic growth.

6 For a description of the then industrial regulatory regime, see: Corporate Studies Group, *Functioning of Industrial Licensing System: A Report*, Indian Institute of Public administration, New Delhi, 1983. Also see S.K. Goyal, *Impact of Foreign Subsidiaries on India's Balance of Payments*, Indian Institute of Public Administration, New Delhi, 1979 and Biswajit Dhar, "State Regulation of Foreign Capital in India", Corporate Studies Group, Indian Institute of Public Administration, 1988, for an elaboration of the expectations from and the policy regime applicable to foreign private capital in India.

7 Arvind Virmani, "India's 1990-91 Crisis: Reforms, Myths And Paradoxes", Planning Commission Working Paper No. 4 /2001-PC, December 2001, p. 37

8 See: "Statement on Industrial Policy July 24, 1991" in Ministry of Commerce and Industry, *Handbook of Industrial Policy and Statistics*, 2001.

9 Ministry of Finance, *Economic Survey: 2008-09*, para 133.

10 India, National Manufacturing Competitiveness Council, *The National Strategy for Manufacturing*, 2006, pp. 23-24.

11 See: Planning Commission, *Report of the Steering Group on Foreign Direct Investment*, August 2002, p. 22 and "Foreign Direct Investment in India: How Can It be Increased?" in IMF, *India: Selected Issues*, January 7, 2005, available at http://www.imf.org/external/pubs/ft/scr/2005/cr0587.pdf.

[12] These include air transport services, ground handling services, asset reconstruction companies, private sector banking, broadcasting, commodity exchanges, credit information companies, insurance, print media, telecommunications and satellites and defence production. Besides, FDI is not permitted in a few areas like agriculture (except floriculture, horticulture, development of seeds, animal husbandry, pisciculture, aquaculture and cultivation of vegetables and mushrooms) retail trading (except single brand product retailing), lottery, gambling and betting, chit fund, mutual benefit financial companies, trading in transferable development rights, real estate, manufacturing of cigars, cigarettes, tobacco or tobacco substitutes, atomic energy, and railway transport (other than mass rapid transport systems). See Consolidated FDI Policy (Effective from October 1, 2010) of the Department of Industrial Policy and Promotion (DIPP), Government of India, available at http://www.dipp.nic.in/FDI_Circular/ FDI_Circular_02of2010.pdf.

[13] As reported by UNCTADSTAT.

[14] UNCTAD, World Investment data.

[15] See for instance: C. P. Chandrasekhar, "Private Equity: A New Role for Finance?", *Economic and Political Weekly*, March 31, 2007, C. P. Chandrasekhar and Jayati Ghosh, "Private Equity and India's FDI Boom", *Business Line*, May 1, 2007; T. T. Ram Mohan , "Are FDI Flows into India for Real?", *Economic Times*, October 5, 2007 and "RBI Confirms FDI Data Included PE Inflows", www.livemint.com, July 9 2007.

[16] *OECD, Benchmark Definition of Foreign Direct Investment*, Fourth Edition, 2008, p. 23.

[17] *Ibid.* pp. 22-23.

[18] CIIs can take several forms, which include investment funds, mutual funds, unit trusts, variable capital companies, investment limited partnerships, feeder/master funds, umbrella funds/sub-funds, funds of funds, hedge funds, professional investor funds, private equity funds, distressed funds, property and real estate funds, and money market funds. See: *supra* note 16, p. 193.

[19] John H. Dunning, "Trade, Location of Economic Activity and the Multinational Enterprise: a Search for an Eclectic Approach", in John Dunning (ed.), *The Theory of Transnational Corporations*, UN Library on Transnational Corporations, Volume I, Routledge, 1993, p. 185. UNCTAD too made similar observations when comparing foreign portfolio and direct investments. See: UNCTAD, *World Investment Report*, 1997, Chapter III (Foreign Portfolio Equity Investment).

[20] Stephen Hymer, "On Multinational Corporations and Foreign Direct Investment" in John Dunning (ed.), *The Theory of Transnational Corporations*, UN Library on Transnational Corporations, Volume I, Routledge, 1993, p. 25.

[21] Interestingly, the European Commission also in its submission to the WTO categorically stated that:

Portfolio investors, as a general rule do not expect to obtain additional benefits derived from the management control of the enterprise in which they invest. Their main concern is the appreciation of the value of their capital and the return that it can generate regardless of any long-term relationship consideration or control of the enterprise. This is the main rationale behind portfolio investment, that makes it substantially different from FDI.

The Commission, however, mentioned that

"… if any of those instruments complies with the criteria of FDI capital transactions they are considered part of FDI".

See: "Concept Paper on the Definition of Investment" WT/WGTI/W/115, 16 April 2002, available at http://trade.ec.europa.eu/doclib/docs/2004/july/tradoc_111123.pdf

[22] Peter J. Buckley and Michael Z. Brooke, *International Business Studies: An Overview*, Blackwell Publishers, Oxford, 1992, p. 249.

[23] Mira Wilkins, *supra* note 1.

[24] UNCTAD, *World Investment Report*, 2010, p. xviii.

[25] UNCTAD, *World Investment Report*, 2006, p. 16.

[26] UNCTAD, *World Investment Report*, 2005, p. 37, n31.
[27] *Supra* note 16, pp. 192-193.
[28] UNCTAD, *World Investment Report*, 2006, p. 21.
[29] In sharp contrast to FDI is the behaviour of private equity.
Private equity professionals have their eye on the exit from the moment they first see a business plan. ... If a fund manager can't see an obvious exit route in a potential investment, then it won't touch it.
See: http://www.altassets.com/private-equity-glossary.html
[30] It is indeed said that: "Ultimately, of course, the private equity business is all about achieving financial returns. Some firms may have aspirations to add value and growth, but that is a means to an end—the goal is to make money." See: "Private Equity in India: An Executive Round Table", at http://content.spencerstuart.com/sswebsite/pdf/lib/PrivateEquityIndia_2007_web2.pdf
[31] Direct Investment Technical Expert Group (DITEG) "Outcome Paper # 2" (Revised version), September 24, 2004. The DITEG was created in 2004 as a joint IMF/OECD expert group.
[32] Draft Summary of the Meeting of the OECD Workshop on International Investment Statistics (October 12-13 2004), prepared by the OECD.
[33] *Supra* note 16, p. 49. Interestingly, the *New Palgrave Dictionary of Economics* does not use the term significant influence. It terms 10 per cent as implying controlling interest when it says:
Foreign direct investment (FDI) occurs when an individual or firm acquires controlling interest (typically defined as at least ten per cent ownership) in productive assets in another country.
Bruce A. Blonigen, "Foreign Direct Investment", in Steven N. Durlauf and Lawrence E. Blume (eds.), *The New Palgrave Dictionary of Economics*, Second Edition, 2008, pp. 459-462.
[34] IMF, *Balance of Payments Manual*, Fifth Edition, 1993, p. 87.
[35] Joint ventures can be entered into for a multitude of reasons, including for coping with the local governance issues. See, Berardi, Nicoletta and Paul Seabright (n.d.), "Joint Ventures as a Commitment Device against Lobbies", (accessed from http://siteresources.worldbank.org/DEC/Resources/84797-1257266550602/BerardiN.pdf)
[36] Richard Schaffer, Beverley Earle and Filiberto Agusti (1999), *International Business Law and Its Environment*, Fourth Edition, West Educational Publishing Co, Cincinnati, p. 581.
[37] Inter-Secretariat Working Group on National Accounts, 1993, pp. 340–1, quoted by Robert E. Lipsey, "Foreign Direct Investment and the Operations of Multinational Firms: Concepts, History, and Data" Working Paper No. 8665, National Bureau of Economic Research, accessed from http://www.nber.org/papers/w8665.
[38] Lipsey, *ibid.*
[39] *Supra* note 33, p. 86.
[40] *Supra* note 21.
[41] See: Eurostat, European Commission, *Foreign Affiliates Statistics (FATS) Recommendations Manual*, Eurostat's Methodologies & Working Papers, 2009 Edition, p. 14. Available at http://epp.eurostat.ec.europa.eu/cache/ITY_OFFPUB/KS-AR-09-014/EN/KS-AR-09-014-EN.PDF. A description of legal provisions in India and how in practice the general perceptions can be defeated has been described in K.S. Chalapati Rao and Biswajit Dhar, "Foreign Direct Investment Caps in India and Corporate Control Mechanisms", *Economic and Political Weekly*, Vol. 46, No. 14, April 2, 2011, pp. 66-70.
[42] US Department of the Treasury, "Regulations Pertaining to Mergers, Acquisitions, and Takeovers by Foreign Persons", Office of Investment Security, Federal Register, Vol. 73, No. 226, November 21, 2008 (accessed from: http://gpo.gov/fdsys/pkg/FR-2008-11-21/pdf/E8-27525.pdf)
[43] *Ibid*, p. 70718.
[44] Tata Engineering & Locomotive Co. Ltd, *Prospectus* dated 14th August 1980.
[45] "Al-Murjan Exits Bilt", http://www.financialexpress.com/news/almurjan-exits-

bilt/105100/0

46 Memorandum and Articles of Association of VST Tillers Tractors Ltd filed on November 10, 2009 with the MCA.

47 Securities and Exchange Board of India, *Report of the Takeover Regulations Advisory Committee*, July 19, 2010, p. 29. (Chairman: C. Achutan)

48 See for example: Nirupam Bajpai and Nandita Dasgupta, "What Constitutes Foreign Direct Investment? Comparison of India and China", CGSD Working Paper No. 1, January 2004, Working Papers Series, Center on Globalization and Sustainable Development, The Earth Institute at Columbia University. Also see: Geng Xiao, "People's Republic of China's Round-Tripping FDI: Scale, Causes and Implications", July 2004 available at www.hiebs.hku.hk/working_paper_updates/pdf/wp1137.pdf.

49 *Supra* note 16, p.158

50 *Ibid.*, pp. 159-160.

51 According to OECD, these "are enterprises that have no direct investment influence upon one another (i.e. the 10 per cent voting power criterion is not met where there is either no equity ownership in one another or it is insufficient for direct investment to exist) but are directly or indirectly influenced in the ownership hierarchy by the same enterprise (which must be a direct investor in at least one of them) …", *ibid*, pp. 25-26.

52 *Ibid*., p. 24.

53 *Ibid.*, pp. 212-213.

54 *Ibid.*, p. 159.

55 RBI, *Report on the Survey of India's Foreign Liabilities and Assets as on 31st December 1955*, 1957, p. 10.

56 RBI, "Finances of Foreign Direct Investment Companies, 1993-94", *RBI Monthly Bulletin*, March 1999, p. 245.

57 *Ibid*.

58 Such a problem could also be associated with studies by some individual researchers who use the 10 per cent criterion indiscriminately. Most scholars would indeed find it extremely difficult to ignore the norm set by international agencies and adopted by the RBI.

59 See: Ministry of Finance, *Report of the Working Group on Foreign Investment*, 30 July 2010, p. 71. (Chairman: U.K. Sinha)

60 Department of Industrial Policy and Promotion (DIPP), Ministry of Commerce and Industry, "Consolidated FDI Policy" (Effective from April 1, 2010) available at http://siadipp.nic.in/policy/fdi_circular/fdi_circular_1_2010.pdf.

61 Draft Press Note: "Regulatory Framework of FDI", issued in December 2009 by the DIPP.

62 *Supra* note 19.

63 Wenhui Wei, "China and India: Any Difference in Their FDI Performances?", *Journal of Asian Economics*, 16 2005, pp. 719–736.

64 http://www.rediff.com/money/2003/apr/12fdi.htm

65 Bain & Company, *India Private Equity Report 2010* available at http://www.bain.com/bainweb/PDFs/cms/Public/India_Private_Equity_Report.pdf

66 India adopted the international practice of reporting FDI inflows data following the recommendations of the RBI Committee on Compilation of Foreign Direct Investment in India, October 2002.

67 This includes, but not restricted to, housing, commercial premises, hotels, resorts, hospitals, educational institutions, recreational facilities, city and regional level infrastructure subject to certain guidelines.

68 Inflows through the FIPB/SIA, Automatic and Acquisition routes.

69 A study by the Standard and Chartered Bank is reported to have identified issues relating to governance (e.g. scams, slow pace of public infrastructure projects and stalled economic reforms) and inflation have hurt investor confidence. It was suggested that unless more sectors are opened up and policies streamlined FDI inflows are unlikely to bounce back. See: "Governance, Inflation Hit FDI Flow", at http://timesofindia.indiatimes.

com/business/india-business/Governance-inflation-hit-FDI-flow/articleshow/7428514.cms. See also: Rajat Guha, "The FDI Trickle", *The Financial Express*, January 2, 2011.

70 RBI, *Macroeconomic and Monetary Developments—Third Quarter Review 2010-11*, at http://www.rbi.org.in/scripts/AnnualPublications.aspx?head=Macroeconomic%20and%20Monetary%20Developments&fromdate=01/23/2011&todate=01/25/2011.

71 *Ibid.* p. 16.

72 The Deputy Chairman of the Planning Commission is also credited with the view that "India needed FDI to bridge the rising current account deficit." See: "India attractive destination despite some slow down: Montek", at http://economictimes.indiatimes.com/news/politics/nation/india-attractive-fdi-destination-despite-some-slowdown-montek/articleshow/7385709.cms

73 Due to the change in reporting format (especially with regard to computer software and electronics) a comparison with the earlier years was not attempted here. Since the inflows increased substantially after 2005-06 and our aim is to understand the developments after 2005-06, this would be a limitation. A broad indication of the position in 2009 is given in Table 7.

74 This data was taken from successive issues of the *SIA Newsletter*. The 2,748 equity inflows accounted for $80.92 bn out of $92.36 bn or 87.61 per cent of the total inflows reported for the period by the SIA on its website. The individual elements of information on inflows are: name of the foreign investor, name of the country from which the amount was remitted, name of the recipient Indian entity, product/activity of the venture, inflow in Indian rupees and equivalent US $. The *SIA Newsletter* offers three lists, one each for FIPB/SIA approvals, payment against acquisition of existing shares and inflows recorded by the RBI under the automatic route.

75 It is quite possible that the same combination of foreign investor and Indian investee company might have reported other inflows too but which were lower than $ 5 mn. each. These were, however, not taken into account in this exercise.

76 The number of companies is only an approximation as we might not have been able to take note of all the name changes in case of Indian investee companies.

77 In sharp contrast to the official figures which indicate that inflows into acquired companies accounted for one-fourth of the FDI inflows (other than that classified as portfolio/PE/VC/HF/round-tripping, etc.) into manufacturing companies, a study observed that the share of such inflows could be as high as half. See: K.S. Chalapati Rao and M.R. Murthy, "Location of FDI in India: Some Less Explored Aspects", forthcoming in *Transnational Corporations Review,* Special Issue on Multinational Enterprises and Development in India.

79 This phenomenon was discussed earlier in some detail in S.K. Goyal, et. al., *Foreign Investment Approvals and Implementation Status: A Review (August 1991 – December 1994),* Institute for Studies in Industrial Development, New Delhi, March 1995.

79 However, cases like Cargill Holdings BV investing in Cargill Capital & Financial Services Pvt Ltd. and HPFS Venture Holdings Ltd. investing in Hewlett Packard Financial Services (India) Pvt Ltd. were also treated as FDI.

80 While venture capital is a subset of private equity and has a different connotation in respect of risky and high technology ventures, available information does not enable an easy and clear-cut distinction between the two. Hence these are very often referred to together.

81 A relevant case is that of Travorto Holdings Ltd of Cyprus which is reported to have invested Rs. 1,418 crore in Tata Capital Ltd. Neither a perusal of the prospectus nor a search of the internet or even the documents filed by Tata Capital with the ROC (available on the Ministry of Corporate Affairs website) yielded any details of the foreign investor. It could be any thing: a PE/VC investor, a case of round-tripping or simple portfolio capital seeking good return or FDI by a foreign financial institution. We have classified it as portfolio investment. Another important case is that of Gypsy Rover (or Gytsy Rover?), a foreign investor in BPL Mobile communication Ltd., about which

only suggestive information is available but no confirmation could be made. Given the circumstances in which it was made, we have treated it as a case of round-tripping. See for instance: "Gypsy Rover Mystery Deepens" at http://economictimes.indiatimes.com/articleshow/3830644.cms?prtpage=1.

Another case which we could finally trace as an OCB belonging to Mr. P.K. Jani and his associates is that of Satin Ltd of British Virginia, a non-promoter shareholder of Standard Industries Ltd with 38.86 per cent share in equity.

82 Here too one finds the leading international audit firms playing multiple roles.

83 It has been reported that Hitech Infra had common directors with KPCL and that it had borrowed funds from the Bahrain branch of ICICI. The proposal was reported to have been approved by the FIPB overruling the objections raised by the Department of Revenue in the Ministry of Finance. See: http://steelguru.com/news/index/Njg5Mjk%3D/ FIPB_approves_Hitech_Infra_investment_in_Krishnapatnam_Port%250D %250A.html (accessed last on May 21, 2010). KPCL also received investment from (i) Chinta Investment Private Co Ltd; (ii) CVR Investments Pvt Co Ltd; and (iii) Navaneeta Investments Pvt Co. Ltd (all of Mauritius) for which post-facto approval was given by the Government. Incidentally, the group is known as CVR Group (after the founder's name C. Visweswara Rao) and Chinta is the surname of the promoter family. Two of the Indian shareholders of the company are: Navaneeta Agriculture Development Co Ltd and Navaneeta Agritech Pvt Ltd. (See the company's filing with the Bombay Stock Exchange available at: http://www.bseindia.com/downloads/ipo/200933116251KPCL-Disclosure %20Document %20-Final.pdf. (accessed last on May 21, 2010)

84 This is by companies like EMAAR of UAE and Capitaland of Singapore.

85 There is, however, a possibility that some of the foreign investors might have subscribed to convertible preference shares/bonds which could get reflected in the equity after conversion.

86 *Supra* note 20.

87 It is even said that "Whereas an Indian-based private equity firm is more likely to understand the particular dynamics affecting an Indian company, US-based firms often mistakenly approach investment opportunities with a belief that a model that works in the US will transpose successfully to India. It can be difficult for them to get the balance right between introducing best practice and discarding what is irrelevant and possibly even damaging for Indian companies." See: "Private Equity in India: An Executive Round Table" at http://content.spencerstuart.com/sswebsite/pdf/lib/PrivateEquityIndia_2007_web2.pdf (Accessed on May 18, 2010).

88 EMPEA Industry Statistics & PitchDeck available at http://www.empea.net/Main-Menu-Category/Resource-Library/EMPEA-Industry-Statistics-PitchDeck-1H-2010-ppt—Public.aspx

89 Ministry of Finance, *Report of the Working Group on Foreign Investment*, 30 July 2010, p. 45.

90 Excluding the Rs. 9,661 crore investment of foreign FVCIs in Indian VCFs.

91 "We're getting enquiries from several investment managers now. The idea of setting up offshore funds is fast catching among Indian asset management companies," said Chetan Nagendra, head of India practice, Harneys Westwood & Riegels, a firm that services clients setting up businesses in British Virgin Islands (BVI) and Cayman Islands. See: "Indian Mutual Funds Approach Zero Tax Destinations to Raise Offshore Capital" at http://economictimes.indiatimes.com/articleshow/5582011.cms?prtpage=1 (last accessed on May 24, 2010). Also relevant here are the observations of Bain & Co cited in Section 2.

92 For example, Helio Venture Partners India LLC, Mauritius FIRE Capital Fund, Nexus India and NEA Indo-US Ventures. Confusion of a similar kind is unavoidable when going though the Ernst & Young's joint publication with Outlook Business magazine—"Private Equity in Numbers", December 2008.

93 Thillai Rajan A. and Ashish Deshmukh, *On Top of the World; Still Miles to Soar,* India Venture Capital and Private Equity Report, Indian Institute of Technology Madras, 2009. There are many indications to suggest that it was the real estate sector that the funds including VCs were targeting. Relaxation of FDI policy and encouragement to SEZs gave

a boost to this phenomenon.

94 PIPE stands for Private Investment in Public Equity *i.e.*, in already stock exchange listed companies.

95 This analysis suffers from serious classification issues.

96 A. Thillai Rajan, "A Life-Cycle Analysis of VC-PE Investments in India", *The Journal of Private Equity*, Winter 2010, Vol. 14, No. 1, pp. 72-82.

97 A. Thillai Rajan and Vishal Kamat, "India Venture Capital and Private Equity Report 2010: Contours of Smart Capital", Indian Institute of Technology, Madras, 2010.

98 UNCTAD, *World Investment Report*, 2009. World includes South-East Europe and CIS.

99 There is a degree of overlap between PE/VC/HF investments and Round-tripping. It is quite relevant to note that Round-tripping related investments increased gradually during the period from just a little less than 2 per cent in 2004 to 21 per cent in 2009. While the share of PE/VC/HF not related to Round-tripping declined from the peak of 34.87 per cent reached in 2007 (in line with the international experience), the share of Round-tripping related PE/VC/HF increased gradually.

100 Indeed, the government had imposed a three-year lock-in for FDI in the real estate sector.

101 Incidentally, it is reported that DIPP had clarified that FIIs cannot take more than 10 per cent equity and that they "will have to follow the rules applicable to portfolio investors even if they are investing through the foreign direct investment route".
See: "FIIs Taking Fdi Route Face 10 Per cent Stake Cap in Local Co" at http://economictimes.indiatimes.com/ articleshow/5814523.cms?prtpage=1

102 Interestingly, the Working Group on Foreign Investment suggested a new category of portfolio investors namely, 'Qualified Foreign Investors' which would subsume FIIs, FVCI and NRI investments. The Working Group also recommended that "(W)ithin the automatic route, there would be no distinction between FDI and portfolio investment". Ministry of Finance, *Report of the Working Group on Foreign Investment*, 30 July 2010, p. 77.

103 For a description of private equity, see: Kavaljit Singh, *Fixing Global Finance*, Madhyam, Delhi and SOMO, Amsterdam, 2010.

104 It may not always be easy to find out on whose behalf the funds have invested. For instance, Rudolf Elmer, a former employee of Julius Baer, a Swiss bank, who has passed on the details of about 2000 of the bank's account holders to Wikileaks explained the modus operandi as:
You are an Indian client and you want to have money in Julius Baer. You have good relationship with a relationship manager who makes investments. The banker sets up a fund in the Cayman Islands and asks his client to invest in that mutual fund. The relationship manager makes the decision to buy the fund and make investments in India for the client…
See: "Leaks Reveal Cayman Black Money Trail", *Mail Today*, January 19, 2011.

105 See for instance: "ED traces key suspect's 2G money trail to Cyprus, Libya, Mauritius", at http://timesofindia.indiatimes.com/india/ED-traces-key suspects-2G-money-trail-to-Cyprus-Libya-Mauritius/articleshow/7080911 cms; "Raids Reveal Mittal-linked Co Got Huge Foreign Inflows" at http://timesofindia.indiatimes.com/india/Raids-reveal-Mittal-linked-co-got-huge-foreign-inflows-/articleshow/6868740.cm; and "2G scam: ED questions Unitech on fund transfers" at http://timesofindia.indiatimes.com/india/2G-scam-ED-questions-Unitech-on-fund-transfers/articleshow/6940321.cms

106 Authority for Advance Rulings (AAR) No. 826 of 2009, dated March 22 2010 available at http://rulings.co.in/it-rulings/uploads/pdf/1269340941_etrade.pdf. DTAC stands for Double Tax Avoidance Convention.

107 *Ibid*.

108 Comptroller and Auditor General of India, *Report No. 13 of 2005, Direct Taxes*. See the relevant chapter of the report available at http://saiindia.gov.in/cag/file/overview-310.

109 Apart from the controversies surrounding the financing of IPL franchisees and the leaked contents of 'Radia tapes' and investigations, we did come across, in this study, companies funded by an alleged arms dealer. Interestingly, press reports also corroborate this observation. For instance, the *Times of India* suggests that the person concerned was

an accused in several cases filed by the CBI for manipulation and bribery in defence purchases and that he was not seen in India since 2006. The paper also reveals that "In India too, the family has several companies, to which investments have come from firms in tax havens". See: "Arms Dealer Wanted In India Major Funder of UK Liberal Democrats", *Times of India*, May 6, 2010.

110 See, RBI, *Macroeconomic and Monetary Developments: Third Quarter Review, 2010-11*, Chapter III on "The External Economy", at http://rbidocs.rbi.org.in/rdocs/Publications/PDFs/ 04MD240111F.pdf.

111 See: "RBI Raises Alarm Over FDI Build-up in Realty", http://economictimes.indiatimes.com/markets/real-estate/realty-trends/rbi-raises-alarm-over-fdi-build-up-in-realty/articleshow/1129254.cms.

112 See: "RBI Asks Govt to Ban Automatic FDI in Real Estate", http://www.indianrealtynews.com/fdi-india/rbi-asks-govt-to-ban-automatic-fdi-in-real-estate.html.

113 IMF, *India: Selected Issues*, *supra* note 11.

114 *Supra* note 37. See also: Jimmy J. Zhan, "FDI Statistics: A Critical Review and Policy Implications", paper prepared for the World Association of Investment Promotion Agencies (WAIPA), Geneva, October 2006.

115 IMF, *Balance of Payment and International Investment Position Manual*, Sixth Edition, 2009, p. 101.

116 Stephen D. Cohen, *Multinational Corporations and Foreign Direct Investment: Avoiding Simplicity, Embracing Complexity*, Oxford University Press, 2007, p. 356.

117 Maria Carkovic and Ross Levine, "Does Foreign Direct Investment Accelerate Economic Growth?", in Theodore H. Moran, Edward M. Graham and Magnus Blomström, *Does Foreign Direct Investment Promote Development?"*, Institute for International Economics, 2005, p. 219.

118 Eric Rugraff, Diego Sánchez-Ancochea, Andy Sumner (eds.), *Transnational Corporations and Development Policy: Critical Perspectives*, Palgrave Macmillan, 2009, pp. 305-306.

119 Ha-joon Chang, "Globalization, Transnational Corporations, and Economic Development: can the Developing Countries Pursue Strategic Industrial Policy in a Globalizing World Economy?", in Dean Baker, Gerald Epstein and Robert Pollin (eds.), *Globalization and Progressive Economic Policy*, Cambridge University Press, 1998, pp. 97-116.

120 World Bank, *Global Development Finance, Charting a Global Recovery, I: Review, Analysis, and Outlook*, 2009, p. 3.

121 In the context of rising current account deficit and falling FDI inflows, the *Economic Times* said in its editorial:

ADRs do make some investible resources available to domestic industry, but is *devoid of the specific benefits associated with FDI*, namely, strategic vision for business growth in the country, technological know-how and managerial expertise. If the government is seriously concerned about our rising current account deficit, estimated at about 3.5 per cent of GDP, an issue that the Reserve Bank of India has also flagged, it needs to look for ways to *increase genuine, rather than sham, FDI flows*. FDI, unlike foreign institutional investment (FII) flows that are easy-come-easy-go, is not only sticky but also has *huge positive externalities in the form of ancillary industries and employment opportunities*. Today, it is hard to think of, say, Suzuki exiting India, certainly not with the ease of some foreign institutional investor. All the more reason why the government should try to reverse the recent trend in overseas capital flows characterised by a decline (in) direct investment and a rise in portfolio flows. (emphasis added)

"ADRs no substitute for FDI", *Economic Times,* January 31, 2011.

On its part a *Business Standard* editorial said on January 3, 2011 that:

It is the composition of capital flows into India in recent times that is a cause of greater concern. India's current account deficit is being financed by short-term capital flows which, as the Financial Stability document of RBI has pointed out, is a cause for serious concern. Short-term capital flows, which increase both short-term debt and vulnerability, are notoriously foot loose and could exit at the first sign of trouble or better opportunity

elsewhere, leaving India dangerously vulnerable. A healthy capital inflow mix would include a greater share of *FDI, which is not only more stable, but brings with it a basket of benefits such as technology transfer, access to export markets, best management practices among others* which can have economy-wide benefits, with the right policy mix in place. (emphasis added)

http://www.business-standard.com/india/news/the-external-constraint/420434/

122 UNCTAD, *World Investment Report*, 2010.

123 Yash Tandon, "FDI, Globalization, UNCTAD and Human Development", available at http://www.twnside.org.sg/title/fdi.htm. Mr. Tandon was former Executive Director, South Centre, Geneva.

124 In fact, it is difficult to reconcile how the number of foreign affiliates are arrived at. For instance, according to the database, there are 59 affiliates under the category 'Publishing, printing and reproduction of recorded media'. But a closer examination reveals that there are no more than 33 affiliates and the higher number is explained by the fact that offices of the same affiliate in different cities are counted as affiliates. That is how Scholastic Corp of USA is shown to have 13 affiliates in India while in actuality only one affiliate Scholastic India Pvt Ltd is shown with 13 entries: two each in Bangalore, Chennai, Gurgaon, Kolkata, Mumbai, Pune and one in Delhi. Employment data is reported only against its Gurgaon office. The registered office of the company is in Gurgaon. The rest may be branches or offices of 'city-based educational coordinators'. Similarly, Cadbury UK's some of the eight affiliates in India are either regional offices/factories/sales offices of Cadbury India Ltd in different locations. Incidentally, some of the factories (Himachal Pradesh, Pune and Gwalior) do not appear among the eleven. Surprisingly, Cadbury India's starting year is reported as 1990 whereas the company started its operations in India in 1948, which fact is also confirmed by the MCA website. On the other hand, Unilever Plc is reported to have 11 affiliates. One, however, finds only four unique companies in the details section with Hindustan Lever Ltd appearing six times and Lever India Exports Ltd three times. The remaining are Diversey Lever and Vashisti Detergents Ltd. Surprisingly except for Lever India Exports Ltd none of the Hindustan Unilever's other nine subsidiaries, or its joint ventures Hi-Tech Surfactants Ltd or Kimberly Clark Lever Pvt Ltd. find a place among the affiliates.

Further, if we go by UNCTAD, the number of foreign affiliates in China declined from 42,753 in 2004 to 25,267 whereas for India they increased from 518 to 3,891.

125 UNCTAD, "Global and Regional FDI Trends in 2010", *Global Investment Trends Monitor*, No. 5, January 17, 2011, available at http://unctad.org/en/docs/webdiaeia20111_en.pdf.

126 UNCTAD, "Global and Regional Trends of FDI Outflows in 2010", *Global Investment Trends Monitor*, No. 6, April 27, 2011 available at http://www.unctad.org/en/docs/webdiaeia20114_en.pdf.

127 See: V.N. Balasubramanyam and Vidya Mahambare, "Foreign Direct Investment in India", paper presented at a workshop on Foreign Direct Investment in Developing Countries held at the Lake District, September 13"14, 2002. This was in response to Nirupam Bajpai and Jeffrey D. Sachs, "Foreign Direct Investment in India: Issues and Problems", Development Discussion Paper No. 759, Harvard Institute for International Development, March 2000, wherein it was posed:

Why is it that India, which provides the largest market after China in the developing world is unable to attract substantial volume of FDI? Further, when it comes to comparing China and India, why can India not match or even outpace China in attracting FDI given India's superior conditions regarding the rule of law, democracy, and the widely spoken English language?

128 *Supra* note 119.

129 While many new foreign companies are not getting listed on the Indian stock exchanges, some of the important existing ones had even got delisted and more have plans to exit. The then Finance Minister, for instance, reported that: "Between 1997-1998 and 2002-2003 we have a total of 62 companies that have been actually de-listed. Out of these 62

companies, 41 are Indian companies and 21 are categorised as multi-national companies." Reply to Lok Sabha Starred Question No. 64 dated February 21, 2003.

Some of the prominent delisted ones are: Avery, Bosch Rexroth, Cadbury, Carrier Aircon, Digital Globalsoft., Hoganas India, iGATE Global Solutions, ITW Signode India, Kodak, Ondeo Nalco, Otis, Panasonic AVC, Philips, Ray Ban, Reckitt Benckiser, Sandvik, Syngenta, Tektronix, Vickers Systems, Wartsila and Yokogawa India.

See also: http://ahmedsk00.blogspot.com/2007/06/mncs-likely-to-delist-names-include-i.html

130 *Supra* note 16, p. 159.

131 UNCTAD, *World Investment Report*, 2006, p. 13.

132 Robert E. Lipsey, "What Do Users Of Fdi Data Want to Learn from them and do the Data Tell Them The Truth?", paper presented at the UNCTAD Expert Meeting on Capacity Building in the Area of FDI: Data Compilation and Policy Formulation in Developing Countries, 12-14 December 2005.

133 The inflows data received by RBI regional offices being offered as proxy for state-wise distribution of FDI reflects poorly on the existing information base on FDI in India. As noted above, one cannot take even UNCTAD's reporting of foreign affiliates in the country at its face value.

134 India, NMCC, *Report of the Prime Minister's Group: Measures for Ensuring Sustained Growth of the Indian Manufacturing Sector*, September 2008, pp. 98-99.

Annexure-A

Illustrative Cases of FDI Inflows which Involve Acquisition of Companies in India But Not All of which are through the 'Acquisition Route'

Route, Month & Year	Indian Company	Foreign Investor	Country	Inflow (Rs. Cr.)
R-1208	Ambuja Cement India Ltd	Holderind Investments Ltd	Mauritius	810.03
A-0407	Anchor Electricals Pvt Ltd	Matsushita Electric Works Ltd	Acquisition of Share	1,440.83
R-0807	Anchor Electricals Pvt Ltd	Matsushita Electrical	Japan	425.67
A-0108	Anchor Electricals Pvt Ltd	Matsushita Electric Works Ltd	Japan	104.99
R-4906	Astrix Laboratories Ltd	Aspen Pharmacare Holding Ltd	South Africa	164.28
R-0508	Balaji Telefilms Ltd	Asian Broadcasting FZ-LLC	U.A.E.	123.25
R-0608	Bhukhanvala Diamond Systems Pvt Ltd	Hilti Far East Pvt Ltd	Singapore	23.74
A-0507	Bombay Stock Exchange	Atticus Mauritius	Mauritius	160.62
A-0507	Bombay Stock Exchange	Callwell Asset Management	Acquisition of Share	160.62
A-0507	Bombay Stock Exchange	Katriel Investment Ltd	Acquisition of Share	160.62
F-0607	Bombay Stock Exchange	Deutsche Boerse AG	Germany	200.78
F-0607	Bombay Stock Exchange	Singapore Stock Exchange	Singapore	200.78
R-0608	Centum Frequency Products Pvt Ltd	Rakon (Mauritius) Ltd.	Mauritius	26.29
R-0705	Dabur Pharma Ltd	International Finance Corp	U.S.A.	65.58
F-0505	DCM Benetton India Ltd	-	Luxembourg	22.50
F-0505	Emergent Genetics India Pvt Ltd	-	Cayman Island	64.80
R-1208	Fresh & Honest Cafe Ltd	Lavazza Netherlands BV	Netherlands	30.00
R-0608	Karnavati Rasayan Ltd	Cabb Holding Gmbh	Germany	22.20
R-0908	MTR Foods Ltd	Orkla Asia Pacific Pte Ltd	Singapore	50.00
R-0908	MTR Foods Ltd	Orkla Asia Pacific Pte Ltd	Singapore	50.00
R-1006	Mysore Cements Ltd (Now Heidelberg Cement India)	Cementrum 1 BV	Netherlands	359.10
A-1006	Mysore Cements Ltd (Now Heidelberg Cement India)	Cementrum 1 BV	Netherlands	203.00

Annexure-A continued...

Annexure-A continued...

Route, Month & Year	Indian Company	Foreign Investor	Country	Inflow (Rs. Cr.)
A-0307	Mysore Cements Ltd (Now Heidelberg Cement India)	Cementrum 1 BV	Netherlands	77.72
A-0708	My Home Industries Ltd	CRH India	-	1,170.53
R-0708	My Home Industries Ltd	CRH India Investments BV	Netherlands	517.36
F-0107	Parryware Roca Pvt Ltd	Roca Sanitario S A	Spain	173.98
A-0808	Parryware Roca Pvt Ltd	Roca Bathroom Investments	Acquisition of Share	747.39
R-1208	Shyamtelelink Ltd	Sistema Joint Stock Financial Corp	Russia	1,482.00
R-0608	SJK Steel Plant Ltd	Corporaction Sidenor Say Cia Src	Spain	79.12
F-1008	SKF Technologies Pvt Ltd	Aktiebolaget SKF	Sweden	35.04
A-0208	Sky Gourmet Catering Pvt Ltd	IHC Mauritius Corp	Mauritius	72.21
R-1108	Sky Gourmet Catering Pvt Ltd	IHC Mauritius Corp	Mauritius	74.51
R-0607	Solvay Specialities India Pvt Ltd	Solyay Holding Netherland BV	Netherlands	225.00
R-1007	UTV Software Communication Ltd	Walt Disney Co	Singapore	65.45
R-0105	Vijay Industries & Projects Ltd	-	U.K.	47.79

Source: SIA Newsletter (various monthly issues).

Note: R: RBI Automatic Route; F: FIPB Approval; A: Acquisition Route. The latter have been included to show the contradictory classification of the inflows from the same foreign investor in the same Indian company.

Annexure-B
Illustrative Cases of Large FDI Inflows where the Indian Investee Company/ Promoter Appears to have Direct Relationship with the Foreign Investors (in Rs. Million)

Indian Investee Company	Entry Route	Source Country	Foreign Investor	Inflow
Adani Energy Ltd	Acquisition	Acquisition of Shares	Opal Travels Ltd	571
Asrani Inns and Resorts Pvt Ltd	Automatic	British Virginia	Global Technology & Trademarks Ltd.	838
Ballarpur Industries Ltd	Acquisition	Unindicated Country	Ballarpur Industries Ltd.	2,785
BILT Graphic Paper Products Ltd	Acquisition	Acquisition of Shares	Ballarpur Paper Holding Bv	6,379
BILT Paper Holdings Ltd	Automatic	Mauritius	NQC Global (Mauritius) Ltd	765
Cox & Kings (India) Pvt Ltd	Acquisition	Mauritius	Kuber Investments (Mauritius) Pvt Ltd	431
Deeksha Holdings Ltd	FIPB	U.K.	Richmond Enterprises Sa	792
Dimexon (India) Holding Pvt Ltd	FIPB	Netherlands	Dimexon Int'l Holding B.V.	499
Essar Bulk Terminal Ltd	Automatic	Cyprus	Essar Shipping & Logistics Ltd.	820
Essar Bulk Terminal Ltd	Automatic	Cyprus	Essar Shipping & Logistics Ltd.	445
Essar Construction Ltd	Acquisition	Mauritius	Essar Projects	1,333
Essar Construction Ltd	Automatic	U.A.E.	Essar Projects Ltd	905
Essar Power	Acquisition	Mauritius	Essar Infrastructure	716
Essar Projects	Acquisition	Unindicated Country	Essar Investment Ltd	4,092
Essar Steel (Hazira) Ltd	Automatic	Mauritius	Essar Steel Holdings Ltd	2,230
Essar Steel Ltd	Acquisition	U.S.A.	Essar Logistics Holdings Ltd	19,039
ETHL Global Capital Ltd	FIPB	Mauritius	Hazira Steel 2	2,250
Geetanjali Effective Realty Sol. Pvt Ltd	Automatic	Mauritius	SEZ Developers Ltd	428
Genext Hardware & Parks Pvt Ltd	Automatic	Mauritius	1 Company (Mauritius) Ltd	625
GTL Infrastructure Ltd	Automatic	Mauritius	Technology Infrastructure	862
GVK Power And Infrastructure Ltd	Automatic	Mauritius	Transoceanic Projects	1,177
Hazira Plate Ltd	Automatic	Mauritius	Essar Steel Holdings Ltd	1,154
Hazira Plate Ltd	Automatic	Mauritius	Essar Steel Holdings Ltd	996
Hazira Plate Ltd	Automatic	Mauritius	Essar Steel Holdings Ltd	495
Hutchison Essar Ltd	FIPB	Mauritius	Essar Com Ltd	1,091
Ispat Industries Ltd	Acquisition	Unindicated Country	Ispat Industries Ltd.	624
Jindal Stainless Ltd	Automatic	Cayman Island	Jindal Overseas Holdings Ltd.	700
Jm Financial Ltd	FIPB	Mauritius	JM Financial Property Fund	593
Jubilant Off Shore Drilling Pvt Ltd	Automatic	Cyprus	Jubilant Energy India Ltd	715
Jubilant Off Shore Drilling Pvt Ltd	Automatic	Cyprus	Jubilant Energy India Ltd	429
Jubilant Oil & Gas Pvt Ltd	Automatic	Cyprus	Jubilant Oil And Gas (I) Ltd	715

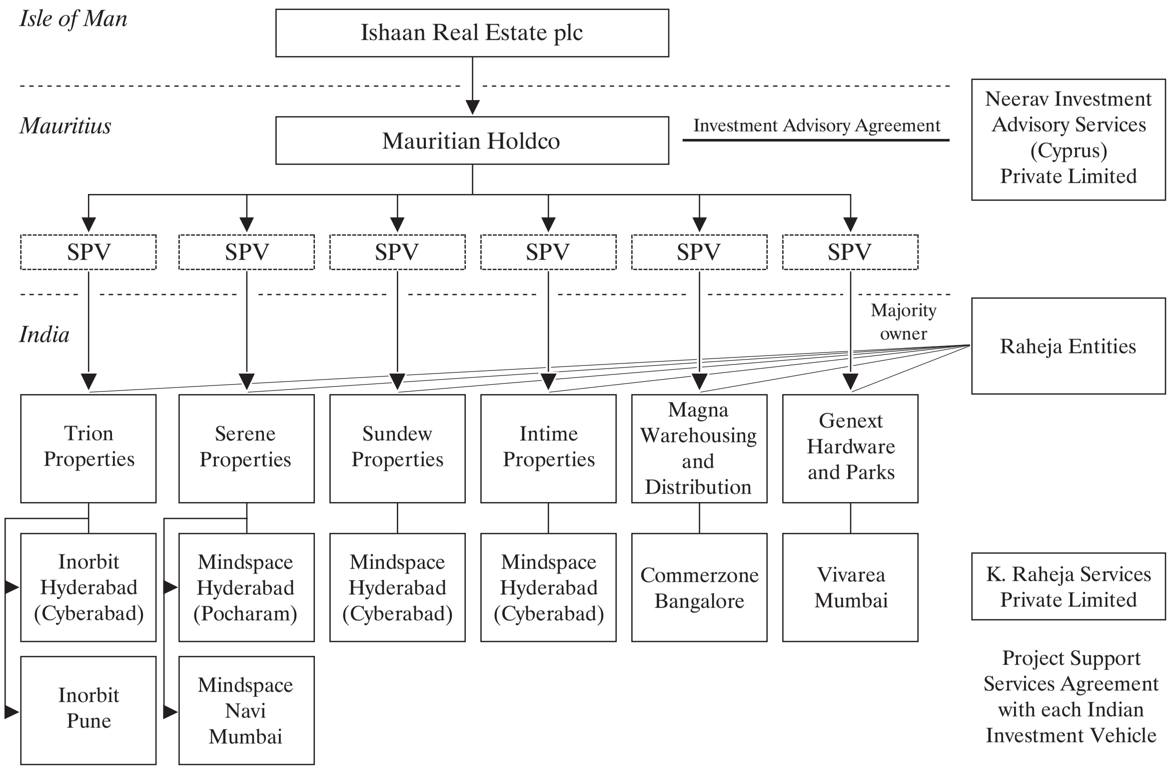
Annexure-B continued...

Annexure-B continued...

Indian Investee Company	Entry Route	Source Country	Foreign Investor	Inflow
Jubilant Oil & Gas Pvt Ltd	Automatic	Cyprus	Jubilant Oil And Gas (I) Ltd	592
Kingfisher Airlines Ltd	Automatic	British Virginia	UB Overseas Ltd.	502
Magna Warehousing & Distribution Pvt Ltd	Automatic	Mauritius	I-4 Company (Mauritius) Ltd	465
Newfound Properties & Leasing Ltd	Acquisition	Acquisition of Shares	Newfound Properties & Leasing Ltd	1,640
Orient Green Power Co Ltd	Automatic	Singapore	Orient Green Power Pte Ltd	757
Ozone Projects Pvt Ltd	Acquisition	Mauritius	Urban Infrastructure Real Estate Fund	844
PVP Ventures Pvt Ltd	Automatic	Mauritius	Platex Ltd	3,777
PVP Ventures Pvt Ltd	Automatic	Mauritius	Platex Ltd	3,758
PVP Ventures Pvt Ltd	Automatic	Mauritius	Platex Ltd	1,329
Rakindo Kovai Township	FIPB	Mauritius	Rakeen P. Ltd	1,274
Reliance Gas Transportation Infrastructure	Automatic	Singapore	Biometrix Marketing Pvt. Ltd.	8,756
Reliance Gas Transportation Infrastructure	Automatic	Singapore	Biometrix Marketing Pvt. Ltd.	7,864
Reliance Gas Transportation Infrastructure	Automatic	Singapore	Biometrix Marketing Pvt. Ltd.	7,665
Reliance Gas Transportation Infrastructure	Automatic	Singapore	Biometrix Marketing Pvt. Ltd.	7,000
Reliance Ports & Terminals Ltd	Automatic	Singapore	Biometrix Marketing Pvt. Ltd.	8,303
Reliance Utilities Ltd	Automatic	Singapore	Biometrix Marketing Pvt. Ltd.	7,000
Relogistics Infrastructure Pvt Ltd	Automatic	Singapore	Biometrix Marketing Pvt. Ltd.	18,519
Ritambara Agents Pvt Ltd	Automatic	Mauritius	Ispat Teleco. Holdings Ltd.	3,741
Seaview Developers Ltd	Automatic	Mauritius	Dotterl Estate Ltd	1,875
Serene Properties Pvt Ltd	Automatic	Mauritius	I-3 Company (Mauritius) Ltd	832
Shantineketan Properties Ltd	Automatic	Mauritius	Acacia Properties	1,111
Shashwat International Ltd	Automatic	Mauritius	Orind South Asia Ltd	536
Shashwat International Ltd	Automatic	Mauritius	Orind South Asia Ltd	536
Solaris Biochemicals Ltd	Automatic	Mauritius	NQC International Mauritius	590
Solaris Chem Tech Ltd	Automatic	Mauritius	NQC International Mauritius	1,492
Steel Corporation Of Gujarat Ltd	Automatic	Mauritius	Gujarat Steel Holdings Ltd.	1,168
Teesta Urja Ltd	Automatic	Singapore	Athena Projects Pte Ltd	1,642
Unitech Developers & Projects Ltd	Automatic	Mauritius	Gladioys Realty Inc	3,266
Unitech Hitech Structures Ltd	Automatic	Mauritius	Myna Holdings Ltd	3,228
Unitech Infra Com Ltd	Automatic	Mauritius	Sparrow Properties Ltd	1,932
Unitech Reality Projects Ltd	Acquisition	Mauritius	Tulipa Investments Inc, Mauritius	5,092
United Breweries (Holding) Ltd	Acquisition	British Virginia	Firstart Inc	862
Vadinar Oil Terminal Ltd	Automatic	Cyprus	Essar Shipping & Logistics Ltd.	897
Vedanta Alumina Ltd	Automatic	Mauritius	Twinstar Holdings Ltd	4,421
Vedanta Alumina Ltd	Automatic	Mauritius	Twinstar Holdings Ltd	3,143

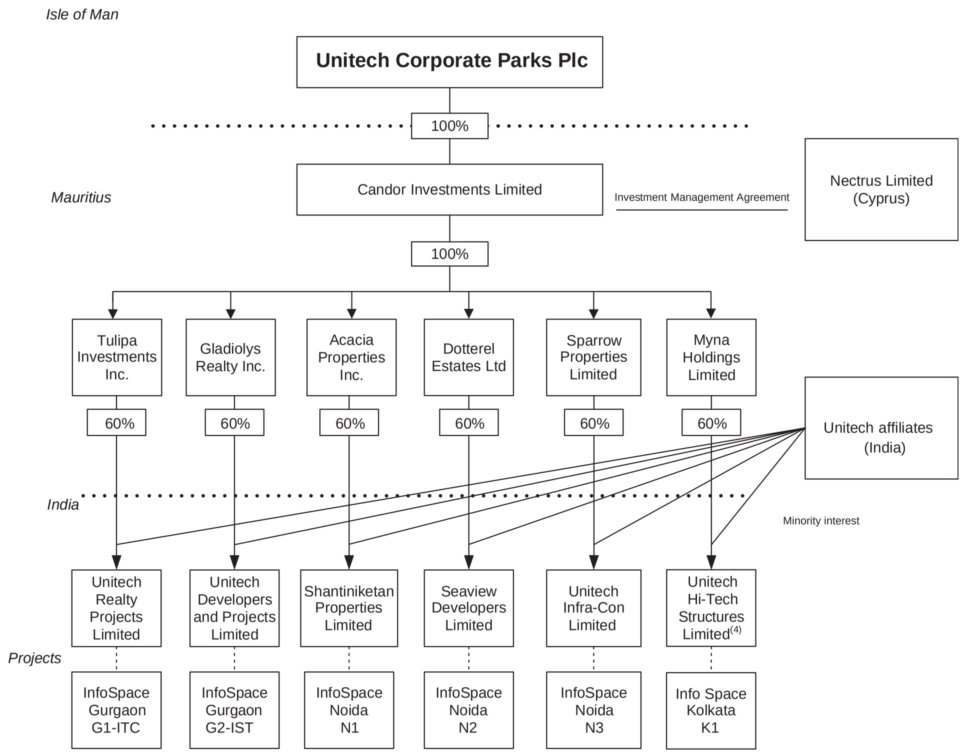
Source: SIA Newsletter (various monthly issues).

Annexure-C1
Corporate structure of Ishaan Real Estate plc.



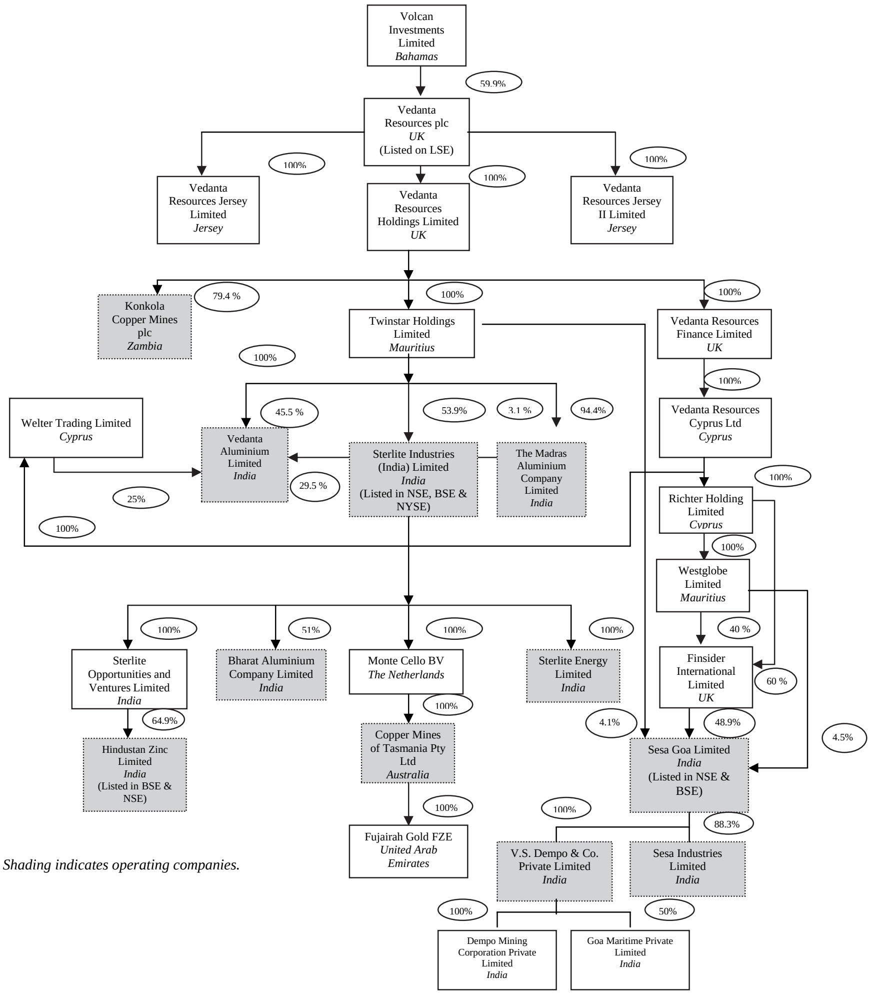
***Source*:** London Stock Exchange AIM Admission document of Ishaan Real Estate plc. available at http://www.ishaanrealestate.com/pdf/Ishaan_Offer.pdf.

Annexure-C2
Corporate Structure of Unitech Corporate Parks plc.



***Source*:** London Stock Exchange AIM Admission document of UNITECH Corporate Parks plc. available at http://www.unitechcorporateparks.com/finaladmissiondocument.pdf

Annexure-C3
Vedanta Group's Organisational Chart# *as on February 28, 2010*



Shading indicates operating companies.

***Note*:**

(1) It was explained that "We also own certain other non-operating subsidiaries that are not material and are not shown in the organisational chart …".

(2) Volcan Investments Ltd owns 162,250,000 Ordinary Shares, or approximately 59.88% of the issued ordinary share capital of Vedanta. Volcan is owned and controlled by the Anil Agarwal Discretionary Trust (Trust). Onclave PTC Ltd (Onclave) is the trustee of the Trust and controls all voting and investment decisions of the Trust. As a result, shares beneficially owned by Volcan may be deemed to be beneficially owned by the Trust and, in turn, by Onclave. Mr. Anil Agarwal, the Executive Chairman of Vedanta (…), may be deemed to have beneficial ownership of shares that may be owned or deemed to be beneficially owned by Onclave.

Source: Offering Circular dated March 26, 2010 available at http://www.vedantaresources.com/uploads/offeringcircular42017bond.pdf

Annexure D
Educational Qualifications and Past Experience of Indians* Working with General Atlantic, a Leading US-Based PE Firm

Name	Position	Educational Qualifications	Previous Employment
Havaldar, Abhay	Managing Director	1. Univ. of Bombay, Bachelor Degree (Electrical Engineering); 2. **London Business School**, Masters in Management	Partner at **Draper International** & **ConnectCapital**
Pandit, Ranjit	Managing Director	1. University of Bombay, BE (Elect. Engg); 2. **Wharton School**, MBA	Managing Director, **McKinsey & Co**
Rai, Raul R.	Managing Director	1. Boston University, B.A. in Computer Science and Economics; 2. **Harvard Business School**, MBA	1. **Vizzavi Ltd., London**, Corporate Strategy & Planning Director. 2. Vice President in the Communication, Media & Technology group at **Goldman Sachs**; 3. **UBS**: Managing Director and Global Co-Head of Software Investment Banking
Sharma, Sunish	Managing Director	1. IIT Delhi, MTech; 2. **Harvard Business School**; MBA	1. Program Associate, Bill & Melinda Gates Foundation 2. Business Analyst, **McKinsey & Co**
Agrawal, Abhishek #	Vice President	**Harvard Business School**, MBA; **Wharton School**, BS in Economics	1. **Lazard's** investment banking group and 2. **Lazard Technology Partners**, a venture capital firm.
Mittal, Nishant	Vice President	1. Delhi College of Engineering; B.E.; 2. University of California Irvine; M.S. in Biomedical Engg; 3. **Stanford Graduate School of Business**; MBA	Business Analyst, **McKinsey & Co**
Sharma, Nishant	Vice President	1. IIT Delhi, M.Tech; 2. **Harvard Business School**, MBA	1. Business Analyst, **McKinsey & Co;** 2. Bill & Melinda Gates Foundation
Soni, Amit #	Vice President	1. B.Tech, IIT Delhi; 2. **Wharton School**, MBA	1. Associate Director, **3i Plc**; 2. Bill & Melinda Gates Foundation; 3. **McKinsey & Co**
Ahmed, Tariq	Senior Associate	**Ross School of Business**, University of Michigan, BBA	1. **Morgan Stanley**, Analyst; 2. **AEA Investors**, Senior Associate; 3. **Blue River Capital**, Vice President

Annexure-D continued...

Annexure-D continued...

Name	**Position**	**Educational Qualifications**	**Previous Employment**
Mehta, Parin	Senior Associate	1. Mumbai University, BE.; 2. Sydenham Institute of Mgt Studies, MBA.	1. Research Analyst, **McKinsey & Co;** 2. Senior Consultant, **Capgemini Consulting.**
Sood, Rajat #	Senior Associate	1. IIT Delhi, B.Tech. (Elect. Engg); 2. IIM Calcutta, MBA	Associate, **McKinsey & Co**
Marathe, Nikhil	Associate	1. Karnataka University; B Com; 2. Institute of Chartered Accountants of India	1. **Merrill Lynch;** 2. **Morgan Stanley** Advantage Services, Associate
Jain, Pratik	Analyst	1. Lucknow University, B.Com; 2. IMT Ghaziabad, MBA	1. First Global Finance; Research Analyst; 2. **JPMorgan** Services India, Analyst

** Identified on the basis of individuals' names.*
 # Based in New York and the remaining, in Mumbai.

The Firm's Senior Management

Name	Position	Educational Qualifications	Previous Employment
Steven A Denning	Chairman	**Stanford Business School**, MBA; Naval Postgraduate School, MS	Consultant, **McKinsey & Co.**
William E Ford	CEO	**Stanford Graduate School of Business**; MBA	**Morgan Stanley & Co**. as an investment banker.
John Bernstein	Managing Director	Downing College, **Cambridge University**; M.A.	Partner, Advent International
Mark F. Dzialga	Managing Director	**Columbia University Graduate School of Business**; MBA,	Co-head of Merger Technology Group, **Goldman Sachs Group**, Inc
William O. Grabe	Managing Director	**UCLA Graduate School of Business**; MBA, 1963 and New York University; BS, 1958	IBM Vice President, General Manager, Marketing and Services, IBM United States
Abhay Havaldar	Managing Director	**London Business School**; MA, 1994 and Degree in Electrical Engineering from University of Bombay.	Partner, ConnectCapital
David C. Hodgson	Managing Director	**Stanford Graduate School of Business**; MBA, 1982 and Dartmouth College; BA	President, New England Software
Rene M. Kern	Managing Director	**Wharton School and School of the Arts & Sciences**, MBA/ MA	Vice President, **Morgan Stanley & Co**. was a management consultant with Bain & Company in Boston, MA
Jonathan Korngold	Managing Director	**Harvard Business School**; MBA and Harvard University; BA	**Goldman Sachs** and Company

Annexure-D continued...

Annexure-D continued...

Name	Position	Educational Qualifications	Previous Employment
Chris Lanning	Managing Director	**University of Virginia**; JD, 1995 and University of Virginia; BA, 1991	Senior Corporate Associate, Hunton & Williams, a Law Firm
Jeff Leng	Managing Director	**Wharton School of Business**, University of Pennsylvania; MBA	Managing Director, **Warburg Pincus**
Anton Levy	Managing Director	**Columbia University Graduate School of Business**; MBA	Financial Analyst, **Morgan Stanley**
Adrianna C. Ma	Managing Director	**Harvard Business School**; MBA, 2000 and Massachusetts Institute of Technology; MEng and BS	Vice President, **Morgan Stanley & Co**
Marc F. McMorris	Managing Director	**Wharton School**, University of Pennsylvania; MBA	Vice President, **Goldman Sachs Group**
Thomas Murphy	Managing Director	**Stern School of Business**, New York University; MBA	Senior Accountant, Deloitte & Touche
Fernando Marques Oliveira	Managing Director	BS; **Fundação Getulio Vargas**, São Paulo	Director, Grupo Icatu
Ranjit Pandit	Managing Director	**Wharton School**, University of Pennsylvania; MBA	Managing Director, **McKinsey & Co**
Drew Pearson	Managing Director	School of the Arts & Sciences, University of Pennsylvania; MA/BA, 1994 and The Wharton Schoo l, University of Pennsylvania; BS	Business Analyst, **McKinsey & Co**
Raul R. Rai	Managing Director	**Harvard Business School**; MBA, 1996	Managing Director, **UBS Goldman Sachs** in New York and London, as Vice President in the Communications, Media & Technology group
David Rosenstein	Managing Director	**New York University School of Law**; JD, 1993	Associate at the New York law firm of Paul, Weiss, Rifkind, Wharton & Garrison.
Sunish Sharma	Managing Director	**Indian Institute of Management**, MBA, 1997; Indian Institute of Cost and Work Accountants, Cost & Work Accountant	Engagement Manager, **McKinsey & Co**
Tom Tinsley	Managing Director	**Stanford Graduate School of Business**; MBA, 1978 and University of Notre Dame; BA, 1975	Chairman and CEO, Baan Company N.V. and Director, **McKinsey & Co**
Philip P. Trahanas	Managing Director	**Wharton School,** University of Pennsylvania; MBA, 1996, The Moore School, University of Pennsylvania	Senior Associate, **Morgan Stanley**
Florian Wendelstadt	Managing Director	**EAP - ESCP; Masters and Dipl Kfm,** 1993 and University of Passau; BA, 1990	Consultant, **Bain Consulting**

Source: Based on the details given at the company's website : http://www.generalatlantic.com
The shaded entries are common to the first list.

Annexure E
Table E.1
Industry/Financing Stage-wise Distribution of PE/VC Investment (2004-2008)

Sector	Share in Total Investment (%)				
	2004	2005	2006	2007	2008
IT & ITES	42.66	12.32	23.86	6.50	11.67
Computer-Hardware	2.75	1.90	0.67	1.13	1.63
Healthcare	11.10	15.77	5.83	3.40	6.02
Manufacturing	15.20	18.50	11.71	7.56	9.19
Engineering & Construction	12.21	6.77	12.05	13.37	27.52
Telecom & Media	3.91	4.49	14.84	21.34	14.96
Transportation & Logistics	0.26	3.48	5.13	4.23	4.92
Financial Services	3.89	13.53	16.45	35.07	10.97
Non-Financial Services	3.23	12.23	6.04	5.41	7.63
Others	4.78	11.02	3.41	1.98	5.50
Financing Stage					
Early	4.55	5.16	7.59	12.47	3.04
Growth	11.31	8.42	16.82	20.41	12.08
Late	20.00	27.68	31.81	24.82	62.51
Pre-IPO	-	4.76	1.99	3.63	4.63
PIPE	34.38	41.97	21.11	33.61	16.11
Buyout	29.76	12.00	20.67	5.07	1.63
Total Investment ($ mn.)	1,759.85	2,108.90	10,095.19	22,014.06	8,117.91

Source: Based on Thillai Rajan A. and Ashish Deshmukh, "India Venture Capital and Private Equity Report", Department of Management Studies, Indian Institute of Technology Madras, 2009.

Table E.2
Stage-wise Distribution of PE/VC Investments in Various Sectors (2004-08)

Sector	Shares of Different Financing Stags in Percentages						Total Investment ($ mn.)
	Early	Growth	Late	Pre-IPO	PIPE	Buyout	
IT & ITES	10.53	16.90	18.39	1.25	10.26	42.66	5,797
Computer-Hardware	10.96	44.57	21.86	6.18	11.79	4.65	538
Healthcare	5.16	17.98	47.02	2.35	26.09	1.40	2,353
Manufacturing	0.69	8.72	39.48	1.24	44.82	5.05	4,249
Engineering & Construction	10.46	23.71	40.08	6.03	17.98	1.74	6,751
Telecom & Media	1.11	8.29	58.15	1.77	29.15	1.53	7,575
Transportation & Logistics	9.55	7.89	41.38	7.73	22.68	10.76	1,927
Financial services	17.11	22.51	14.47	1.69	40.93	3.29	10,626
Non-Financial services	11.98	23.82	32.80	4.21	14.89	12.31	2,735
Others	0.51	7.11	24.24	17.96	34.60	15.57	1,544
All	8.95	17.12	33.30	3.35	27.96	9.33	44,096

Source: See Table E.1.

Annexure-E continued...

Annexure-E continued...

Table E.3
Financing Stage wise Distribution of Investment in 2007 in Different Regions and India

in %

Financing Stage	India	Asia	North America	Europe
Early	12.50	8.00	6.00	3.00
Expansion (Growth + Late)	45.30	20.00	11.00	13.00
Other (PIPE+Pre-IPO)	37.20	24.00	12.00	5.00
Buyout	5.00	48.00	71.00	79.00
All	100.00	100.00	100.00	100.00

Source: See Table E.1.

This study dwells on the ambiguities surrounding the definition of FDI and the non–adherence to international norms in measuring the FDI inflows by India. The study finds that portfolio investors and round–tripping investments have been important contributors to India's reported FDI inflows thus blurring the distinction between direct and portfolio investors on the one hand and foreign and domestic investors on the other. These investors were also the ones who have exploited the tax haven route the most. These observations acquire added significance in the context of the substantial fall in the inflows seen during 2010–11.

Even at the global level, the developmental impact of FDI is being given lesser importance notwithstanding the repeated assertions by some to the contrary. Acceptance of the definition of FDI based on only 10 per cent voting rights, and which ignores the essential attributes of the foreign investor, could have contributed to this discourse in no small measure. There is a need to take a close look at the present phenomenon of FDI. A move away from this situation seems possible only if FDI is defined precisely instead of the omnibus capital flow which it has been turned into now. UNCTAD with its mandate to promote "the development–friendly integration of developing countries into the world economy" appears to be not only the appropriate institution that should take the lead to clear the haze but also the one having the responsibility to do it. On her part, India should build an information base that will allow a proper assessment of the contribution that FDI can make to her economic development.

RIS
Research and Information System for Developing Countries

Core IV-B, Fourth Floor, India Habitat Centre,
Lodhi Road, New Delhi-110 003 India.
Ph.: 91-11-24682177-80,
Fax: 91-11-24682173-74,
Email: publication@ris.org.in
Website: http://www.ris.org.in

Institute for Studies in Industrial Development **ISID**

4, Institutional Area Phase-II, Vasant Kunj,
New Delhi - 110 070, India.
Ph.: 91-11-26761600-1899
Fax: 91-11-26761631
Email: info@isid.org.in
Website: http://www.isid.org.in